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PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO

JUNE 30, 2004 AND 2003

FINANCIAL STATEMENTS

AND

INDEPENDENT AUDITORS' REPORT

DOCUMENTS DEPT.

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**Port Commission
City and County of San Francisco
Port of San Francisco**

**Financial Statements and
Independent Auditors' Report**

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Independent Auditors' Report

THE HONORABLE EDWARD HARRINGTON
CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

We have audited the accompanying balance sheet of the **PORT COMMISSION, CITY AND COUNTY OF SAN FRANCISCO, PORT OF SAN FRANCISCO (the Port)**, an enterprise fund of the City and County of San Francisco, as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Port as of June 30, 2004 and 2003, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 - 9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Hood & Strong LLP

October 12, 2004

Consultants and

Business Advisors

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**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Overview of the Financial Statements

This discussion and analysis is a narrative overview and analysis of the financial activities of the Port of San Francisco (Port). It serves as an introduction to the audited financial statements, which can be found on pages 10 - 34 of this report. This overview should be read in conjunction with the more detailed information contained within the accompanying financial statements.

The Port is a self-supporting enterprise department of the City and County of San Francisco (City) and its financial statements are included in the City's Comprehensive Annual Financial Report. Only the accounts of the Port are included in the financial statements that follow. The Port Commission is responsible for seven and one-half miles of waterfront property, which was transferred in trust from the State of California to the City in 1969. The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations, which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Additional information concerning the Port's organization and the basis of presentation for this financial report is contained in Note 1 to the financial statements (pages 14 - 15).

The Balance Sheet presents information on all of the Port's assets and liabilities, with the difference between the two reported as "net assets." Increases and decreases in net assets serve as a useful indicator of the financial position of business enterprise entities like the Port. Comparative information of the Port's financial position is presented as of June 30, 2004 and 2003.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Port's net assets changed during the most recent two fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. uncollected rents from tenants and earned, but unused vacation leave).

The Statement of Cash Flows presents information about the cash receipts and cash payments of the Port during the most recent two fiscal years. This statement shows the effects on financial position of cash and non-cash operating, investing, capital, and financing transactions. When used with related disclosures and information in the other financial statements, the information in the Statement of Cash Flows helps readers assess the Port's ability to generate net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes follow the financial statements and can be found on pages 14 - 34 of this report.

Following is a presentation of certain condensed financial information derived from the basic financial statements.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Condensed Financial Information – Port of San Francisco

Comparative Net Assets (in thousands)

	June 30,			
	2004	2003	Change	% Change
Current and other assets	\$ 87,841	\$ 82,817	\$ 5,024	6.1
Capital assets	245,445	247,655	(2,210)	(0.9)
Total assets	333,286	330,472	2,814	0.9
Long-term debt obligations	30,382	34,382	(4,000)	(11.6)
Other liabilities	26,944	28,018	(1,074)	(3.8)
Total liabilities	57,326	62,400	(5,074)	(8.1)
Net assets:				
Invested in capital assets, net of related debt	224,407	222,211	2,196	1.0
Restricted	11,190	2,128	9,062	425.8
Unrestricted	40,363	43,733	(3,370)	(7.7)
Total net assets	\$ 275,960	\$ 268,072	\$ 7,888	2.9

Changes in Net Assets (in thousands)

	Year Ended June 30,			
	2004	2003	Change	% Change
Revenues:				
Program revenues:				
Rents and other operating revenues	\$ 56,702	\$ 54,467	\$ 2,235	4.1
Capital grants and other contributions	2,745	726	2,019	278.1
General revenues	1,089	2,168	(1,079)	(49.8)
Total revenues	60,536	57,361	3,175	5.5
Total expenses	61,893	63,781	(1,888)	(3.0)
Change in net assets before Special Item	(1,357)	(6,420)	5,063	(78.9)
Special Item – Gain from sale of land	9,245		9,245	100.0
Increase (decrease) in net assets	7,888	(6,420)	14,308	(222.9)
Net assets, beginning of the year	268,072	274,492	(6,420)	(2.3)
Net assets, end of the year	\$ 275,960	\$ 268,072	\$ 7,888	2.9

2000

**Port Commission
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Port of San Francisco**

Management's Discussion and Analysis

Financial Analysis (in thousands)

Assets exceeded liabilities by \$275,960 at the close of the most recent fiscal year. Total net assets as of June 30, 2004 increased \$7,888 from June 30, 2003. This increase contrasts with a \$6,420 decrease posted for the previous year. This change is largely attributed to different nonrecurring revenue and expense transactions occurring in each of these fiscal years. In 2004, the Port closed escrow on a sale of land to a developer and realized a gain of \$9,245. Without this special revenue item, total revenues reported for the year ended June 30, 2004 were \$3,175 over the previous year. Total expenses in 2004 decreased \$1,888 from 2003. The more significant variances and nonrecurring transactions are discussed below in more detail.

The largest portion of the Port's net assets, 81 percent at June 30, 2004 and 83 percent at June 30, 2003, reflects its investment in capital assets (e.g. land, buildings and equipment). The Port is responsible for a seven and one-half mile stretch of waterfront land and its revenue is derived primarily from property rentals to commercial and industrial enterprises and a diverse mix of maritime operations. As disclosed in Note 1 to the financial statements, land transferred from the State of California to the City is reported at an amount which includes an increase over historical cost of \$56,063. This amount was recorded by the State to reflect appraised values in 1929. The total amount of net assets tied to capital assets (\$224,407 at June 30, 2004) represents assets that are not available for future spending. Although the investment in capital assets is reported net of related debt, the resources needed to repay the debt must be provided from other sources (i.e. other Port assets or operating revenues). The capital assets themselves cannot be used to liquidate those liabilities. The remaining portion of net assets at June 30, 2004 consists of \$11,190 restricted by current agreements for specified capital expenditures and \$40,363 that is unrestricted and available to meet the Port's ongoing obligations and future capital investments.

The Statement of Revenues, Expenses and Changes in Net Assets on page 11 presents the Port's operating revenues in more detail by industry revenue types. Operating revenues for the year ended June 30, 2004 increased \$2,235 or 4.1%. This increase was largely derived from commercial and industrial rental, parking and cruise revenues. As set forth in Note 9 to the financial statements (page 27), overall property rentals across all revenue types posted a net increase of \$1,719 in 2004: \$783 from minimum or base rentals and \$936 from percentage rents over minimum base rents. Parking revenues increased \$688, reflecting higher income from parking meters following a rate increase effective October 2003 and higher parking lot revenues. Cruise revenues continue to rise (\$615 in 2004) as a direct result of increased vessel calls, passenger counts and tariff changes. Other maritime revenues decreased slightly in 2004; but this decrease was more than offset by the increase in cruise revenues. In 2003, cargo related revenues (facility rents and vessel revenues) posted increased revenues of \$1,862, reflecting several new lease and/or expansion agreements executed at marine terminal facilities. Cargo vessel revenues continue to be offset by increased operating costs pursuant to a terminal operating agreement. Other Operating Revenues include permit fees and various one-time fees realized from major development projects and certain leases on Port property. Other Operating Revenue in 2004 included reimbursements of \$99 from a federal security assessment grant (\$400 in 2003).

Capital grants and contributions consist principally of funds received or receivable from federal, state and local grant agencies which provide funding for many of the Port's capital projects.

Table 1: Summary of Data

Category		Sub-category		Value	
A	A1	A1.1	A1.1.1	10	20
			A1.1.2	15	30
			A1.1.3	20	40
			A1.1.4	25	50
A	A2	A2.1	A2.1.1	30	60
			A2.1.2	40	80
			A2.1.3	50	100
			A2.1.4	60	120
B	B1	B1.1	B1.1.1	70	140
			B1.1.2	80	160
			B1.1.3	90	180
			B1.1.4	100	200
B	B2	B2.1	B2.1.1	110	220
			B2.1.2	120	240
			B2.1.3	130	260
			B2.1.4	140	280
C	C1	C1.1	C1.1.1	150	300
			C1.1.2	160	320
			C1.1.3	170	340
			C1.1.4	180	360
C	C2	C2.1	C2.1.1	190	380
			C2.1.2	200	400
			C2.1.3	210	420
			C2.1.4	220	440
D	D1	D1.1	D1.1.1	230	460
			D1.1.2	240	480
			D1.1.3	250	500
			D1.1.4	260	520
D	D2	D2.1	D2.1.1	270	540
			D2.1.2	280	560
			D2.1.3	290	580
			D2.1.4	300	600
E	E1	E1.1	E1.1.1	310	620
			E1.1.2	320	640
			E1.1.3	330	660
			E1.1.4	340	680
E	E2	E2.1	E2.1.1	350	700
			E2.1.2	360	720
			E2.1.3	370	740
			E2.1.4	380	760
F	F1	F1.1	F1.1.1	390	780
			F1.1.2	400	800
			F1.1.3	410	820
			F1.1.4	420	840
F	F2	F2.1	F2.1.1	430	860
			F2.1.2	440	880
			F2.1.3	450	900
			F2.1.4	460	920
G	G1	G1.1	G1.1.1	470	940
			G1.1.2	480	960
			G1.1.3	490	980
			G1.1.4	500	1000
G	G2	G2.1	G2.1.1	510	1020
			G2.1.2	520	1040
			G2.1.3	530	1060
			G2.1.4	540	1080
H	H1	H1.1	H1.1.1	550	1100
			H1.1.2	560	1120
			H1.1.3	570	1140
			H1.1.4	580	1160
H	H2	H2.1	H2.1.1	590	1180
			H2.1.2	600	1200
			H2.1.3	610	1220
			H2.1.4	620	1240
I	I1	I1.1	I1.1.1	630	1260
			I1.1.2	640	1280
			I1.1.3	650	1300
			I1.1.4	660	1320
I	I2	I2.1	I2.1.1	670	1340
			I2.1.2	680	1360
			I2.1.3	690	1380
			I2.1.4	700	1400
J	J1	J1.1	J1.1.1	710	1420
			J1.1.2	720	1440
			J1.1.3	730	1460
			J1.1.4	740	1480
J	J2	J2.1	J2.1.1	750	1500
			J2.1.2	760	1520
			J2.1.3	770	1540
			J2.1.4	780	1560
K	K1	K1.1	K1.1.1	790	1580
			K1.1.2	800	1600
			K1.1.3	810	1620
			K1.1.4	820	1640
K	K2	K2.1	K2.1.1	830	1660
			K2.1.2	840	1680
			K2.1.3	850	1700
			K2.1.4	860	1720
L	L1	L1.1	L1.1.1	870	1740
			L1.1.2	880	1760
			L1.1.3	890	1780
			L1.1.4	900	1800
L	L2	L2.1	L2.1.1	910	1820
			L2.1.2	920	1840
			L2.1.3	930	1860
			L2.1.4	940	1880
M	M1	M1.1	M1.1.1	950	1900
			M1.1.2	960	1920
			M1.1.3	970	1940
			M1.1.4	980	1960
M	M2	M2.1	M2.1.1	990	1980
			M2.1.2	1000	2000
			M2.1.3		
			M2.1.4		

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Management's Discussion and Analysis

All revenues not reported in the foregoing condensed summaries as Program Revenues, as defined in Government Accounting Standards Board Statement No. 34, are presented as General Revenues. General Revenues for 2004 and 2003 consisted of interest and investment income (\$1,080 and \$1,774, respectively) and the gain from fire insurance proceeds received for the construction repairs at Pier 43 (\$9 and \$394, respectively).

Total expenses of \$61,893 for 2004 represent a \$1,888 decrease from 2003. Comparatively, total expenses for 2003 of \$63,781 were a \$3,428 increase over 2003. One-time charges accounted for some of the expense increases in recent years. Other increases occurred in operating cost items like insurance and workers compensation, where management expects some normalization in future periods. The more significant cost and expense increases and decreases in 2004 included the following:

- Claims and judgments (\$1,193 increase) – Increase reflects the final settlement of several claims and judgments, related expenses, and provision for probable ultimate losses related to matters pending final settlement.
- Depreciation and amortization (\$892 increase) – New assets placed in service and an adjustment to the economic life of a facility pursuant to an asset survey resulted in the 2004 increase.
- Dredging (\$541 increase) – Additional dredging costs were incurred around the Pier 35 cruise ship terminal.
- Direct services of other city departments (\$416 increase) – Increase reflects the procurement of supporting services from the Department of Building Inspection in connection with Port development projects and funding of a departmental performance audit conducted by the Board of Supervisors Budget Analyst.
- Recovery of damaged dry dock (\$1,716 decrease) – As discussed in Note 12 to the financial statements, \$1,716 was expended in 2003 to recover, repair and secure a floating dry dock that went adrift during a winter storm.
- General Fund reimbursements (\$1,305 decrease) – In 2003, the Port Commission approved a preliminary \$2.0 million settlement for under-reimbursement of certain services for fiscal years 2000-01 through 2002-03. A nexus study that analyzed the balance of payments determined that the Port owed \$2.2 million to the City's general fund as received for 2000-01 through 2002-03, and that payments of \$0.8 to \$1.0 million will likely be due thereafter. The total decrease in 2004 reflects a single-year obligation for General Fund services identified in the nexus study plus a current reduction in the countywide overhead allocation applicable to the Port.
- Retirement costs (\$905 decrease) – Collective bargaining agreements covering substantially all employees mandated employee-paid contributions in 2004. Previously, the Port paid some or all such contributions on behalf of such employees.
- Remediation of contaminated soils (\$300 decrease) – In 2003, additional charges of \$800 were recorded for the final disposal of lead-contaminated soils left at Pier 92. In 2004, a \$500 liability was recorded for the remediation of PCB contamination resulting from vandalized electrical transformers at Pier 70, Building 50.

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Port of San Francisco**

Management's Discussion and Analysis

The operating expense for the cargo terminal in 2004 approximated 2003. The management agreement between the Port and its terminal operator at Pier 80 was amended and changed the underlying arrangement to one of guaranteed compensation to the terminal operator effective September 2001. Consequently, the gross amount due to the terminal operator under this arrangement has been recorded as an operating expense in the accompanying financial statements (\$2.6 million in 2004 and \$2.7 million in 2003).

As discussed in Note 14, the Port received a September 2002 notice of violation from the California Department of Toxic Substances Control (DTSC) in connection with a large quantity of abandoned soil on Port property. The soil was contaminated with soluble lead in concentrations that classify it as hazardous waste in California. Management initially considered remediation options with costs in the range of \$800 to \$1,200. The Port ultimately selected and obtained approval for immediate removal of the soils to an out-of-state landfill. The final completed cost of the removal and related costs amounted to \$1,600.

In connection with the Piers 30-32 mixed-use cruise terminal development project, and as approved by state legislation in 2001 (Assembly Bill No. 1389), a portion of Seawall Lot No. 330 was sold to a developer in 2004. The land was sold for \$9,324, slightly above its appraised fair value. The Port realized a gain from the sale of \$9,245. Certain proceeds from the land sale (\$9,000) are restricted for the construction of a public plaza area called Brannan Street Wharf. The remaining proceeds of \$324, together with certain residual receipts from the sale of residential condominium units built on the land sold, are restricted for the construction of the cruise terminal.

Capital Asset and Debt Administration

Capital assets. The Port's investment in capital assets as of June 30, 2004 amounts to \$245.4 million, net of accumulated depreciation. This investment in capital assets includes land, certain street and road improvements, pier promenades, pier substructure, buildings and related improvements, vehicles, equipment and furniture. As of June 30, 2004, capital assets, net of depreciation and amortization, decreased about one percent from 2003. There was a more modest level of acquisition and construction activity in 2004. Additional information on the Port's capital assets can be found in Note 4 on page 20 of this report.

Port Engineering staff has been performing facility condition surveys to identify and prioritize required maintenance projects that will preserve and extend the economic life of the Port's productive assets. At June 30, 2004, \$30 million remain appropriated for capital project related expenditures, including pier repair and major maintenance projects.

**Port Commission
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Port of San Francisco**

Management's Discussion and Analysis

Major capital asset events of fiscal 2004 and 2003 included the following:

- A design-build contract was awarded in November 2003 for the Illinois Street Intermodal Bridge ("Bridge"). The Bridge will be constructed over Islais Creek one block and will extend Illinois Street from the north side of the creek, adjacent to the Pier 80 cargo terminal, to Pier 90 on the south side of the creek. Construction of this bridge will provide replacement freight rail service to Pier 80 previously accessed via Potrero Way at 16th Street. The Bridge will provide for two-way truck/vehicular traffic across the Bridge, opening of the Bridge for watercraft in the creek, and bicycle and pedestrian access across the Bridge. The estimated total project cost is currently \$22.5 million.
- Approximately \$1.3 million has been expended toward completion of the Ferry Terminal Public Pier. This project connects the freestanding breakwater at the Downtown Ferry with the Embarcadero Promenade and adds public pedestrian improvements to the top of breakwater. Grant applications are pending for funding of the final phase of this project. Upon completion, pedestrians will be able to walk out over the Bay; fish; view interpretative signage about ferry activities, Bay currents and habitat; observe ferry operations in the adjacent harbor; and enjoy views of the City and the Bay Bridge.
- Since a 1996 fire, a total of \$14.7 million of construction work has been completed at Pier 48. Insurance-funded repair to fire-damaged facilities on the pier and certain seismic repairs to the pier were completed in June 2003. Port-funded electrical service upgrades were completed in November 2003. The pier will return to leasable property inventory after a required CEQA determination process.
- Insurance-funded repairs to the historic ferry arch at Pier 43 were completed in 2003. Total construction and related costs were \$1.5 million, of which approximately \$1.3 million was funded by insurance.
- Approximately \$2.8 million was expended to repair the marginal wharf area adjacent to the seawall at the entrance to Pier 3. The completed work was required to preserve the main entrance and public access breezeway at the pier.

The Port has entered into a number of public/private partnerships with developers for the historical preservation, renovation, and redevelopment of Port properties. Current information concerning major development projects and opportunities can be found at the Port's website: www.sfport.com. The more significant activities and events include:

Ferry Building Rehabilitation – Redevelopment of the Ferry Building was completed and the building re-opened in Spring 2003. The landmark building, restored to former grandeur, has ground floor retail, transportation and public uses, and upper floor office and other commercial uses. The project is fully leased in 2004.

Piers 1½ - 5 – The project development agreement and lease was approved by the Port Commission in March 2003 and approved by the Board of Supervisors in August 2003. The project calls for rehabilitation of historic bulkhead buildings with ground floor restaurants, upper floor office, public access walkways, boat docks and a water taxi landing. Construction commenced in April 2004.

**Port Commission
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Management's Discussion and Analysis

Bryant Street Piers Mixed Use and Cruise Terminal Development – The project transaction documents were approved by the Port Commission in March 2003 and by the Board of Supervisors in July 2003. The project is planned as a mixed use development with a two-berth cruise ship terminal, ground floor retail and restaurant, and upper floor office and entertainment uses on Piers 30-32. Construction of the cruise terminal is projected to commence in 2006 after other development work. Phase I commenced in March 2004 and entails the construction of a residential condominium tower on a portion of Seawall Lot 330. Construction of a related bayfront urban park on The Embarcadero between Piers 30-32 and Pier 38 (“Brannan Street Wharf”) is expected to commence in Fall 2005.

Other development projects are in various stages of review and negotiation under exclusive rights agreements.

Long-term obligations. Detailed information concerning the Port’s long-term obligations can be found in Note 8 on pages 22 - 26 of this report. As of June 30, 2004, the Port had total long-term obligations of \$30,382 including \$4,420 that will mature during the next fiscal year. The total includes \$400 in general obligation bonds which are backed by the full faith and credit of the City, \$26,523 in revenue bonds, \$3,436 in loans that are secured by specified revenue sources, and \$23 in a capital lease obligation which is secured by certain equipment. No new debt was issued during the years ended June 30, 2004 and 2003.

As discussed in Note 8, the Port issued new refunding revenue bonds in August 2004 to current refund the outstanding Series 1994 Revenue Bonds. The current refunding was completed to take advantage of lower interest rates, reducing total debt service over the next five years. The term of the bonds was not extended.

Economic and Other Factors

Economy. The general national and local economic downturn and the events of and subsequent to September 11, 2001 have negatively affected tourist travel and tourist dependent sales venues in the City. As is standard with retail leases, a minimum fixed rent is paid to the Port at the beginning of every month. Revenue loss to the Port during this period was limited to some decline in overage rents (percentage rents above the minimum) and increased delinquencies. After an extended period of reduced patronage, the Port’s restaurant and retail tenants in the aggregate have reported stronger sales activity in 2004. While a vacancy factor in the 20% range and declining rents has hit the local downtown office market, Port properties have fared much better. The Port has been able to maintain a fixed rent roll at approximately \$3.3 million per month. Most of the Port’s property rentals are covered by term leases and Note 9 (page 27) contains required financial statement disclosure information covering the future rental income stream from minimum rents over the noncancellable term of active operating leases.

The economic recovery has been fairly slow. It will likely be several years before the positive effect of this recovery will be realized. General economic conditions were taken into consideration in preparing current budgets and forecasts. The Port currently expects, in the aggregate, to be able to maintain revenues at current levels with modest year-to-year growth. City and Port managers will take prudent steps to closely monitor revenue streams and to control expenditures.

**Port Commission
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Port of San Francisco**

Management's Discussion and Analysis

San Francisco Waterfront Special Area Plan. In July 2000, the Port agreed to amend its Waterfront Land Use Plan, and the San Francisco Bay Conservation and Development Commission (BCDC) its San Francisco Bay Plan to create consistent plans for the waterfront area between the Hyde Street Pier and China Basin (San Francisco Waterfront Special Area Plan). Among other things, the Special Area Plan commits the Port to expend up to \$30 million over a 20-year period for the removal of certain piers and the construction of major public plazas and other public access improvements. As of June 30, 2004, \$14.3 million has been appropriated and \$1.6 million has been expended for projects under the agreement.

Assembly Bill No. 1389, signed by the Governor of California in October 2001 to authorize approval of the development plans for a cruise ship terminal at Piers 30-32, also ratifies the San Francisco Waterfront Special Area Plan adopted by the Port and BCDC. Among other things, the legislation accelerated a requirement for the construction of one public plaza area, the Brannan Street Wharf. Construction of the estimated \$15 million plaza project is anticipated to commence in Fall 2005. The Port is aggressively seeking other funding sources (i.e. grants and contributions) to finance the required pier removals and public access improvements. Until sufficient funding from other sources is secured, the Port must commit significant capital funds for the Special Area Plan projects.

Port security. The Port is a recipient of the Port Security Grants Program, which was established by the federal government to finance security enhancements at critical national seaports. Under this program, managed by the Transportation Security Administration (Department of Homeland Security), the Port received a first round grant in the amount of \$0.5 million to conduct a comprehensive security assessment study of the its waterfront facilities. Subsequently, the Port was awarded a total of \$3.9 million in the second and third round funding for certain capital improvements that improve facility and operational security at the Port's cruise, ferry and cargo facilities. The Port of San Francisco also participates in a regional Port Security Committee, which reviews security issues and needs affecting ports and terminals in the San Francisco Bay Area.

Requests for Information

This report is designed to provide a general overview of the Port of San Francisco's finances. The financial statements and related informative disclosures in the notes to the financial statements and required supplementary information is presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Public Information Officer or the Fiscal Officer at Pier 1, San Francisco, California, 94111.

Questions concerning the City and County of San Francisco or requests for a copy of the City's Comprehensive Annual Report should be addressed to:

Office of the Controller
City and County of San Francisco
City Hall, Room 316
#1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4694

**Port Commission
City and County of San Francisco
Port of San Francisco**

Balance Sheet (In Thousands)

<i>June 30,</i>	2004	2003
Assets		
Current Assets:		
Cash and investments, held in City Treasury - Port operating fund	\$ 60,777	\$ 52,842
Cash outside of City Treasury	5	9
Receivables - net	4,618	4,173
Materials and supplies	1,270	1,193
Prepaid insurance and other assets	697	1,322
Total current assets	67,367	59,539
Restricted Assets:		
Cash held in City Treasury:		
Lessee deposits	3,506	3,192
Capital outlay	636	667
Bond interest and redemption held by trustee	10,060	9,896
Capital outlay funds held by escrow agent		671
Other - Lessee deposits	742	793
Total restricted assets	14,944	15,219
Capital Assets - net	245,445	247,655
Other Assets	5,530	8,059
Total assets	\$ 333,286	\$ 330,472
Liabilities		
Current Liabilities Payable from Current Assets:		
Accounts payable and accrued liabilities	\$ 14,212	\$ 16,269
Current maturities of long-term obligations	500	518
Accrued interest payable	144	149
Total current liabilities	14,856	16,936
Current Liabilities Payable from Restricted Assets:		
Current maturities of revenue bonds	3,920	3,595
Accrued bond interest payable	779	940
Lessee deposits	4,248	3,985
Deferred grants	145	145
Total payable from restricted assets	9,092	8,665
Noncurrent Liabilities	4,512	3,571
Deferred Revenue- Net of current portion	2,904	2,959
Long-term Obligations - Net of current maturities	25,962	30,269
Total liabilities	57,326	62,400
Net Assets:		
Invested in capital assets, net of related debt	224,407	222,211
Restricted	11,190	2,128
Unrestricted	40,363	43,733
Total net assets	275,960	268,072
Total liabilities and net assets	\$ 333,286	\$ 330,472

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Statement of Revenues, Expenses and Changes in Net Assets (In Thousands)

<i>Years Ended June 30,</i>	2004	2003
Operating Revenues:		
Commercial and industrial	\$ 33,489	\$ 32,037
Parking	8,154	7,466
Cargo	5,561	5,659
Fishing	1,454	1,554
Ship repair	867	919
Harbor services	991	967
Cruise	1,578	963
Other maritime	1,319	1,413
Other	3,289	3,489
Total operating revenues	56,702	54,467
Operating Expenses:		
Operations and maintenance	49,707	50,103
Depreciation and amortization	9,547	8,655
Total operating expenses	59,254	58,758
Operating loss	(2,552)	(4,291)
Other Income (Expense):		
Interest and investment income	1,080	1,774
Interest expense	(1,931)	(2,316)
Gain from fire insurance settlement	9	394
Loss from disposition of assets	(708)	(2,707)
Total nonoperating revenues and expenses	(1,550)	(2,855)
Capital Contributions - Capital grants and other contributions	2,745	726
Special Item - Gain from sale of land to a developer	9,245	-
Change in Net Assets	7,888	(6,420)
Net Assets - beginning of the year	268,072	274,492
Net Assets - end of the year	\$ 275,960	\$ 268,072

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Statement of Cash Flows (In Thousands)

<i>Years Ended June 30,</i>	2004	2003
Cash Flows from Operating Activities:		
Cash received from tenants for rent	\$ 45,887	\$ 43,998
Cash received from customers	8,020	7,006
Deposits received from tenants and customers	428	280
Cash paid to employees for services	(20,582)	(19,995)
Cash paid to suppliers for goods and services	(11,915)	(9,606)
Cash paid for quasi-external transactions	(11,180)	(9,665)
Customer deposits returned	(114)	(205)
Net cash provided by operating activities	10,544	11,813
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment	(7,706)	(14,448)
Dredging	(1,631)	(3,380)
Capital grants received	2,427	1,145
Contributed capital other than from grants		437
Net insurance proceeds from fire casualties	429	
Principal payments on long-term debt	(4,103)	(4,720)
Interest payments on long-term debt	(1,930)	(2,253)
Recovery and repair of surplus drydock		(1,716)
Pier demolition and other asset disposition costs	(676)	(892)
Proceeds from sale of land	9,000	
Proceeds from sale of equipment and materials	25	20
Net cash used by capital and related financing activities	(4,165)	(25,807)
Cash Flows from Investing Activities:		
Interest income received	1,834	2,083
Investments sold by Trustee		5,359
Net cash provided by investing activities	1,834	7,442
Net Increase (Decrease) in Cash and Cash Equivalents	8,213	(6,552)
Cash and Cash Equivalents - Beginning of year	66,718	73,270
Cash and Cash Equivalents - End of year	\$ 74,931	\$ 66,718

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**Statement of Cash Flows (In Thousands)
(Continued)**

<i>Years Ended June 30,</i>	2004	2003
Noncash Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment included in accounts payable and accrued liabilities	\$ 363	\$ 473
Loss on abandonment of property and equipment	39	119
Noncash Investing Activities:		
Change in fair value of cash and investments held in City Treasury	\$ (506)	\$ (200)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating loss	\$ (2,552)	\$ (4,291)
Adjustment to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation and amortization	9,547	8,655
Change in allowance for doubtful accounts	(966)	365
Net change in deferred revenue	(661)	(831)
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables	284	25
Materials and supplies	(77)	(40)
Prepaid insurance and other assets	5,056	3,766
Increase (decrease) in:		
Accounts payable and accrued liabilities	(401)	4,088
Lessee deposits	314	76
Net cash provided by operating activities	\$ 10,544	\$ 11,813
Reconciliation of Cash and Cash Equivalents to the Balance Sheet:		
Cash and investments held in City Treasury - Port operating fund	\$ 60,777	\$ 52,842
Cash deposit outside of City Treasury	5	9
Cash held in City Treasury:		
Lessee deposits	3,506	3,192
Capital outlay	636	667
Cash held by escrow agent		671
Cash held by Trustee - Bond interest and redemption (see Note 2)	10,060	9,896
	74,984	67,277
Change in fair value of cash and investments held in City Treasury	(53)	(559)
Cash and Cash Equivalents	\$ 74,931	\$ 66,718

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Notes to Financial Statements

Note 1 - Significant Accounting Policies:

a. Basis of Presentation

The Port of San Francisco (Port) is an enterprise fund of the City and County of San Francisco (City). Only the accounts of the Port are included in these financial statements. There are no component units that should be considered for inclusion in the Port's financial reporting entity.

A five-member Port Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for fixed terms of four years. The Port is an integral part of the City, and the accompanying financial statements are included in the City's Comprehensive Annual Financial Report.

Prior to February 1969, the Port was owned by the State of California ("State") and administered by the San Francisco Port Authority, a State agency. In February 1969, the State transferred the Port in trust to the City under the terms and conditions specified in the State statutes of 1968, Chapter 1333 ("Burton Act"), as amended, and ratified by the City's voters in November 1968.

Under the terms of the Burton Act, the State Legislature reserved the right to amend, modify, or revoke, in whole or in part, the transfer of lands in trust, provided that the State would then assume all lawful obligations related to such lands.

The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Substantially all of the Port's property rental customers are located within the boundaries of the City.

The Port's financial statements are prepared on the accrual basis in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). In addition, the Port applies all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

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Notes to Financial Statements

In accordance with GASB Statement No. 34 (GASB 34) "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," the balance sheet presents the difference between assets and liabilities as net assets. Net assets are reported in three broad components, as applicable – invested in capital assets, net of related debt; restricted; and unrestricted. Under the all-inclusive approach to presenting the changes in net assets, all Port revenues, including capital contributions, are reported in the statement of revenues, expenses and changes in net assets.

b. Cash and Investments

The Port reports its investments at fair value based upon quoted market prices. Fair value is defined as the amount that the Port could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short term investments are reported at cost (or amortized cost), which approximates fair value. For purposes of the statement of cash flows, all unrestricted and restricted cash and highly liquid investments with maturities of three months or less, when purchased, are considered to be cash equivalents. In addition, the Port considers its deposits with the City Treasurer (see Note 2) to be demand deposits and therefore cash for the purposes of the statement of cash flows.

c. Materials and Supplies

Materials and supplies are used for construction and maintenance of Port facilities and are stated at average cost.

d. Restricted Assets

Bond interest and redemption represent funds accumulated for debt service payments due in the next twelve months and reserve funds set aside to make up potential future deficiencies. A bond trustee holds these funds.

Capital outlay funds are restricted for use in construction and acquisition of equipment, due to restrictions from federal and state grant agreements and bond resolutions. A bank escrow agent held certain insurance settlement proceeds received for the seismic upgrade of a pier.

e. Capital Assets

Land transferred to the City in February 1969 is stated at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State in prior years to reflect appraised values in 1929.

**Port Commission
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Notes to Financial Statements

Other property, plant and equipment is carried at cost or at fair market value at the date received in the case of property received by donation or by termination of a lease. Donated surplus equipment received from the federal government is carried at an estimated value determined in accordance with federal guidelines. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets. Land improvements (principally pavement and pier promenades) with a cost of approximately \$19 million are not depreciated because, in the opinion of management, the assets will be maintained to provide indefinite useful lives. Building (tenant) improvements are amortized using the straight-line method over the shorter of the estimated life of the asset or the remaining term of the related lease. Maintenance and repairs are expensed as incurred.

Interest paid on bond funds used for construction purposes, less interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, if applicable, is capitalized from the date of borrowing through the construction period.

f. Other Assets

Bond issue costs are amortized using the straight-line method over the life of the bond. Original bond issue premiums are offset against the related debt and amortized using the straight-line method over the life of the bonds.

Dredging costs are amortized using the straight-line method over the estimated useful period ranging from one to seven years.

Waterfront Land Use Plan (Plan) costs are amortized using the straight-line method over an estimated life of 20 years. The Plan was approved by the City Board of Supervisors in September 1997.

g. Deferred Revenue

Deferred revenue consists primarily of rent credits issued to customers. Deferred revenue is recognized in accordance with the lease agreements and is amortized using the straight-line method over the term of the specific leases.

**Port Commission
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Notes to Financial Statements

h. Refunding Debt

The Port's revenue bonds were refunded in 1994 (see Note 8). The difference between the reacquisition price and the net carrying amount of the old debt is deferred and reported as a reduction of the bonds payable. The amount is being amortized on a straight-line basis over 15 years.

i. Capital Contributions

The Port, at various times, receives federal and state grants and funds from other external sources for construction of waterfront facilities. The funds are reported as capital contributions on the Statement of Revenues, Expenses and Changes in Net Assets.

j. Environmental Expenses

The Port incurs costs associated with environmental clean-up which arise during the normal course of business. These costs are recorded as a liability when the Port is required to perform the cleanup and the costs can be reasonably estimated.

k. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2 - Cash and Investments:

The Port maintains its operating fund cash and investments and a portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The Comprehensive Annual Financial Report of the City categorizes the level of risk associated with the City's pooled cash and investments.

**Port Commission
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Notes to Financial Statements

Cash and investments, reported at fair value, at June 30, 2004 and 2003 are as follows (in thousands):

	2004	2003
Cash and investments in City treasury	\$ 60,777	\$ 52,842
Cash outside of City treasury	5	9
Restricted assets:		
Cash and investments in City treasury	4,142	3,859
Deposits and investments outside City treasury:		
Cash and investments held by bond trustee	10,060	9,896
Cash and investments held by escrow agent		671
Lessee deposits	636	739
	\$ 75,620	\$ 68,016

Cash deposits consist of the following (in thousands):

	<u>June 30, 2004</u>		<u>June 30, 2003</u>	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Federally insured deposits	\$ 574	\$ 573	\$ 668	\$ 667
Uninsured and uncollateralized deposits	67	67	76	76
	\$ 641	\$ 640	\$ 744	\$ 743

Lessee security deposits are held on behalf of the Port by third party trustees and invested in renewable certificates of deposit. At June 30, 2004, one security deposit for \$167,000 exceeds the federal insurance limit. Two security deposit accounts at June 30, 2003 had bank balances that exceeded the federal insurance limit.

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Notes to Financial Statements

At June 30, 2004 and 2003, cash and investments held in reserve and for debt service payments by trustee consist of:

	2004	2003
	(in thousands)	
Reserve Fund:		
U.S. Treasury Obligation Fund	\$ 5,361	\$ 5,361
Debt Service Funds:		
U.S. Treasury Obligation Fund	4,699	4,535
	<u>\$ 10,060</u>	<u>\$ 9,896</u>

All investments held by the bank escrow agent are in a money market mutual fund.

Note 3 - Receivables:

At June 30, 2004 and 2003, receivables consisted of:

	2004	2003
	(in thousands)	
Trade accounts receivable	\$ 3,941	\$ 4,635
Less allowance for doubtful accounts	(784)	(1,750)
	3,157	2,885
Grants receivable	468	439
Insurance proceeds receivable	750	420
Accrued interest receivable	123	371
Other	120	58
	<u>\$ 4,618</u>	<u>\$ 4,173</u>

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Notes to Financial Statements

Note 4 - Capital Assets:

At June 30, 2004 and 2003, capital assets consisted of:

	2004 (in thousands)	2003	Estimated Useful Life (Years)
Land and land improvements	\$ 119,452	\$ 119,512	
Buildings, structures and related improvements	265,826	250,121	5 - 64
Furniture, machinery and equipment	13,368	12,877	2 - 20
Total	398,646	382,150	
Less accumulated depreciation	(165,257)	(157,564)	
	233,389	224,946	
Construction work in progress	12,056	22,709	
Total	\$ 245,445	\$ 247,655	

Total interest cost was \$1,764,000 and \$2,149,000 for fiscal years 2004 and 2003. Total interest earned was \$1,585,000 and \$1,965,000 for fiscal years 2004 and 2003. No interest cost and earnings were capitalized in 2004 and 2003.

The buildings, structures and improvements identified above include pier substructures, which have an estimated useful life greater than 50 years. Such long-lived assets total \$21,915,000 as of June 30, 2004 and 2003.

The cost of fully depreciated assets still in use was approximately \$84,093,000 at June 30, 2004, including \$79,517,000 in buildings, structures and improvements and \$4,576,000 in furniture, machinery and equipment.

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Notes to Financial Statements

Note 5 - Other Assets:

Other assets at June 30, 2004 and 2003, net of related amortization, consisted of:

	2004	2003
	(in thousands)	
Deferred debt	\$ 264	\$ 317
Dredging costs	2,612	5,238
Waterfront land use plan	2,185	2,350
Note receivable from land sale	324	
Other deferred costs	145	154
	<u>\$ 5,530</u>	<u>\$ 8,059</u>

The note receivable of \$324 is the deferred portion of the \$9,324 total purchase price for land sold to a developer in 2004. The Port realized a gain of \$9,245 from this sale of land. The deferred amount plus interest is payable to the Port from certain residual receipts derived from the developer's future sale of residential condominium units built on the land sold. Interest on the note accrues at the prime or reference rate of a bank plus two percent (6.25% at June 30, 2004).

Note 6 - Accounts Payable and Accrued Liabilities:

At June 30, 2004 and 2003, accounts payable and accrued liabilities consisted of:

	2004	2003
	(in thousands)	
Accounts payable	\$ 2,770	\$ 2,396
Due to City General Fund	598	2,000
Current portion of deferred revenue	4,565	5,171
Accrued liabilities	4,591	4,233
Accrued payroll, compensated absences and related costs	1,688	2,469
	<u>\$ 14,212</u>	<u>\$ 16,269</u>

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Notes to Financial Statements

Note 7 - Noncurrent Liabilities:

At June 30, 2004 and 2003, noncurrent liabilities consisted of:

	2004	2003
	(in thousands)	
Compensated absences and related costs	\$ 849	\$ 884
Workers' compensation	2,463	2,287
Litigation, claims and judgments	1,200	400
	<u>\$ 4,512</u>	<u>\$ 3,571</u>

Note 8 - Long-Term Obligations:

Long-term obligations at June 30, 2004 and 2003 consisted of the following:

	Interest Rate (%)	Fiscal Year Last Series Matures	Balance 2004	2003
			(in thousands)	
Revenue bonds	5.50 - 9.00	2010	\$ 26,523	\$ 30,004
General obligation bonds	6.30	2003 - 2005	400	800
Loan payable	4.50	2029	3,436	3,510
Capital lease	6.31	2005	23	68
Total long-term obligations			30,382	34,382
Less current maturities			(4,420)	(4,113)
Net long-term obligations			<u>\$ 25,962</u>	<u>\$ 30,269</u>

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Notes to Financial Statements

The following is a summary of changes in long-term obligations for the years ended June 30, 2004 and 2003 (in thousands):

	Revenue Bonds	General Obligation Bonds	Loans	Capital Lease	Total
Balances as of June 30, 2002	\$ 33,295	\$ 2,000	\$ 3,584	\$ 108	\$ 38,987
Current maturities, retirements and other decreases	(3,291)	(1,200)	(74)	(40)	(4,605)
Balances as of June 30, 2003	30,004	800	3,510	68	34,382
Current maturities, retirements and other decreases	(3,481)	(400)	(74)	(45)	(4,000)
Balances as of June 30, 2004	\$ 26,523	\$ 400	\$ 3,436	\$ 23	\$ 30,382

The annual requirements to amortize all outstanding long-term obligations are as follows (in thousands):

	Bonds	Loan	Capital Lease	Total
<u>Year Ending June 30:</u>				
2005	\$ 5,794	\$ 232	\$ 25	\$ 6,051
2006	5,361	232		5,593
2007	5,355	232		5,587
2008	5,342	232		5,574
2009	5,334	232		5,566
2010 – 2014	5,323	1,158		6,481
2015 – 2019		1,159		1,159
2020 – 2024		1,158		1,158
2025 – 2029		1,158		1,158
Total debt service	32,509	5,793	25	38,327
Less - interest	(5,586)	(2,357)	(2)	(7,945)
Total liability - June 30, 2004	\$ 26,923	\$ 3,436	\$ 23	\$ 30,382

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Notes to Financial Statements

Bonds

Bond obligations at June 30, 2004 and 2003 consisted of the following:

	Interest Rate (%)	Fiscal Year Last Series Matures	Balance	
			2004 (in thousands)	2003
General Obligation Bonds:				
City and County of San Francisco - Harbor Improvement 1971, Series B	6.30	2005	\$ 400	\$ 800
Total General Obligation Bonds			400	800
Revenue Bonds:				
Series 1994	5.50 - 9.00	2010	27,095	30,690
Total Revenue Bonds			27,095	30,690
Total Bond Obligations			27,495	31,490
Less:				
Current maturities			(4,320)	(3,995)
Unamortized Revenue Bond Series 1994 bond premium			216	260
Deferred amount on refunding			(788)	(946)
Net Bond Obligations			\$ 22,603	\$ 26,809

In 1994, the Port issued \$53,610,000 in Revenue Refunding Bonds, Series 1994 with an average interest rate of 5.8 percent to refund \$49,975,000 of outstanding 1984 Revenue Bonds, Series A, B and C with an average interest rate of 8.4 percent.

The refunding resulted in a difference between the reacquisition price (principal of the old debt plus call premium) and the net carrying amount of the old debt of \$2.36 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the fiscal year 2010 using the straight line method.

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Notes to Financial Statements

Under the terms of the Revenue Refunding Bonds, Series 1994 Indenture, the Port is required to deposit with a trustee in a reserve fund, an amount equal to the lesser of (a) maximum debt service accruing in any year during the life of such bonds, (b) ten percent (10%) of the proceeds derived from the sale of Series 1994 Bonds, or (c) 1.25 times the average annual debt service due with respect to Series 1994 Bonds. At June 30, 2004, the Port was in compliance with this bond indenture requirement.

While Series 1994 Bonds are outstanding, the Port may not create liens on its property essential to operations, dispose of any property essential to maintaining revenues or operating the Port, and must maintain specified insurance. The Port may issue additional bonds under the 1994 Indenture provided the Port complies with the Additional Bonds Test, as defined in the indenture.

Covenants of the 1994 Indenture include that the Port will maintain its business operations, and establish, and maintain rentals, rates, fees, and charges for the use of Port property and for services rendered by the Port so that the Net Revenue, as defined in the bond indenture, in each fiscal year will be at least equal to 130% of aggregate annual debt service for such fiscal year. At June 30, 2004, the Port was in compliance with such bond covenants.

The revenue bonds are secured by a pledge of Net Revenues of the Port, as defined by the bond indenture. Certain general obligation bonds issued by the City are subordinated to the revenue bonds and any future senior lien revenue bonds.

The Series 1994 Revenue Bonds are subject to an arbitrage rebate requirement. The requirements stipulate, in general, that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. There is no cumulative arbitrage liability as of June 30, 2004.

Revenue Refunding Bonds, Series 2004

On August 12, 2004, the Port issued \$19,940,000 in refunding revenue bonds with an average interest rate of 3.16% to current refund \$23,175,000 of outstanding Series 1994 Revenue Bonds with an average coupon rate of 5.84%. Net proceeds from the new bonds plus an additional \$3.9 million of Series 1994 debt service monies were used to defease the 1994 bonds. The Port completed the current refunding to reduce its total debt service payments over the next five years by \$1.6 million and to obtain an economic gain (difference between the present value of the old and new debt service payments) of \$1.2 million. This refunding also resulted in a difference between the reacquisition price (principal of the old debt plus 2 % call premium) and the net carrying amount of the old debt of \$0.5 million.

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Notes to Financial Statements

Loans

The Port has entered into a loan agreement with a State Agency for \$3.5 million to finance a certain capital project. The loan is subordinate to all bonds payable by the Port. Interest accrues at a rate of 4.5% per annum on the unpaid balance commencing with the first draw on the loan. The term is 30 years from the date of the first draw, which occurred in April 1998. The loan is secured by Gross Revenues as defined in the loan agreement. The project was completed as scheduled in 2002 and annual payments commenced on August 1, 2002.

	2004	2003
	(in thousands)	
Loan payable to State Agency	\$ 3,436	\$ 3,510
Less current portion	(77)	(74)
Net loan payable	\$ 3,359	\$ 3,436

Capital Lease

In 1999, the Port entered into a lease purchase agreement for certain equipment. This lease arrangement is accounted for as a capital lease. At June 30, 2004, equipment under this lease arrangement totaled approximately \$200,000 and accumulated amortization on those assets at June 30, 2004 and 2003 totaled \$134,000 and \$102,000, respectively.

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Notes to Financial Statements

Note 9 - Operating Revenues - Property Rentals:

Certain property rental agreements specify rental payments based on a percentage of tenant sales, subject to a minimum amount. Property rental revenues were comprised as follows:

	2004	2003
	(in thousands)	
Minimum rentals	\$ 38,493	\$ 37,710
Percentage rentals	8,084	7,148
	<u>\$ 46,577</u>	<u>\$ 44,858</u>

Minimum future rental income under noncancellable operating leases having terms in excess of one year are as follows:

<u>Year Ending June 30</u>	(in thousands)
2005	\$ 27,311
2006	23,530
2007	21,173
2008	19,719
2009	17,941
Thereafter	369,279
Total	<u>\$ 478,953</u>

The approximate cost of property subject to operating leases and property held for lease at June 30, 2004 consisted of:

	(in thousands)
Land and land improvements	\$ 52,473
Buildings, structures, and related improvements at cost, less accumulated depreciation of \$141,353	<u>63,727</u>
Total	<u>\$ 116,200</u>

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Notes to Financial Statements

Note 10 - Employee Benefit Plans:

a. Retirement Plans

City and County of San Francisco

Plan Description - The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Port along with other employees of the City. The Plan provides basic service retirement, disability and death benefits based on specified percentages of defined final average salary and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, California 94102 or by calling (415) 487-7020.

Funding Policy - Contributions are made to the basic plan by both the Port and its employees. Employee contributions are mandatory. Employee contribution rates for 2004 and 2003 varied from 7.0% to 8.0% as a percentage of covered payroll. The Port is required to contribute at an actuarially determined rate. No Port contributions were required for 2004 and 2003 as the actuarially determined contribution rate as a percentage of covered payroll was 0%. The Port's contributions to the Retirement System on behalf of its employees amounted to \$8,000, \$908,000 and \$1,210,000 for the years ended June 30, 2004, 2003 and 2002, respectively. Certain collective bargaining agreements effective in 2004 and 2003 mandated employee-paid contributions at various levels. In 2004, substantially all required employee contributions were paid to the Retirement System by such affected employees. In 2003, certain groups of employees contributed 2.75% of covered payroll as employee-paid employee contributions and the Port's contributions to the Retirement System on behalf of such employees were reduced to 4.25% to 5.25%. For those groups of employees not mandated to contribute to the Retirement System, the Port's contributions remained at 7.0% to 8.0% of covered payroll. The Port's contributions in 2002 were equal to the required employee contributions.

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**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

State of California

Plan Description - The Port also contributes to the California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the state of California. Certain employees who commenced their employment at the Port prior to February 1969 are eligible to participate in PERS. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

Funding Policy - Participating employees are required to contribute 7 percent of their salary to PERS. The Port is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis recommended by PERS actuaries and actuarial consultants and adopted by the Board of Administration.

There were no contributions required in 2004, 2003 and 2002. The City's Comprehensive Annual Financial Report contains disclosures for all covered City employees. Amounts for the Port are not separable from the City totals.

b. Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code (IRC) Section 457. The Plan, available to all Port employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

In accordance with GASB Statement No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans", Plan assets and related liabilities to Plan participants are not included in the City's financial statements. The City has no fiduciary accountability for the Plan. It has no administrative involvement and does not perform the investing function.

The amounts deferred by Port employees totaled \$1,114,121, \$1,038,000, and \$934,000 for 2004, 2003 and 2002, respectively.

**Port Commission
City and County of San Francisco
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Notes to Financial Statements

c. Health Care Benefits

Health care benefits of Port employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System. The Port's contribution, which amounted to approximately \$820,000, \$742,000 and \$637,000 in fiscal years 2004, 2003 and 2002, respectively, is determined by Charter provision based on similar contributions made by the ten most populous counties in California. The cost of providing benefits for the retirees is not separable from the cost of providing benefits for the active employees. The Port's liability for both current employee and post retirement health care benefits is limited to its annual contribution. The Port's contribution is paid out of current available resources and funded on a pay-as-you-go basis. The Health Service System issues a publicly available financial report that includes financial statements and supplementary information for the health care benefits. That report may be obtained by writing to the San Francisco Health Service System, 1145 Market Street, 2nd Floor, San Francisco, CA 94103 or by calling (415) 554-1700.

d. Wellness Incentive Program

Effective July 1, 2002, the City established, on a pilot basis, a Wellness Incentive Program (the Program) to promote workforce attendance. Under the Program, any full-time employee leaving employment of the City upon service or disability retirement may receive payment for a portion of accrued sick leave credits at the time of separation. The amount of this payment is based on two and one-half percent of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, is not included in this computation. The pilot program extends through June 30, 2006 and the estimated future payments under the Program are included in the accrued liabilities disclosed in Notes 6 and 7.

Note 11 - Related Party Transactions:

The Port receives services from, and provides services to, various City departments. The cost of services received, included as operating expenses in the financial statements, was approximately \$11,180,000 in 2004 and \$11,665,000 in 2003.

**Port Commission
City and County of San Francisco
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Notes to Financial Statements

Services provided, included in operating revenue, amounted to approximately \$3,770,000 and \$4,178,000 in 2004 and 2003, respectively. Receivables relating to such transactions are disclosed in Note 3. Under a guaranteed payment agreement for parking fine revenues collected from Port property, the Port received \$1.2 million from the Department of Parking and Traffic in 2004 and 2003.

Note 12 - Dry Dock # 1:

In November 2002, a maritime vessel known as Dry Dock #1 broke free from its moorings at Pier 70 and went adrift in very high winds, finally running aground on Yerba Buena Island. The Port entered into emergency contracts to recover the dry dock vessel and to complete certain repairs to restore and maintain its watertight condition. The Port is evaluating options for the final disposition of this surplus vessel. During the fiscal year ended June 30, 2003, \$1,716,000 was expended for the recovery and repairs.

Note 13 - Fire Insurance Proceeds:

On November 26, 1996, a fire at the east end of Pier 48 destroyed the interconnecting wood frame structure and caused substantial structural damage to the steel frames, walls and roof at the easterly end of Sheds A and B on the pier. On July 14, 1998, a fire damaged the historic ferry slip arch structure at Pier 43 and the one-story auxiliary building connected to the arch's west tower. Insurance was in force to cover fire damage to the Port's property at Pier 48 and Pier 43. The gain recognized as other income in the Statement of Revenues, Expenses and Changes in Net Assets represents proceeds received or receivable for construction repair in excess of clean-up expenses incidental to the casualty.

In January 2002, the Port and its insurers reached a settlement to resolve disputes regarding coverage for damage caused by the Pier 48 fire and the required construction repairs, including code upgrades. The Port received insurance payments of \$6,770,000 for approved repairs. An additional \$8,000,000 was placed in an escrow account to fund certain seismic retrofit work. The seismic retrofit work has been completed and final payment was made to the contractor in June 2003. The account residual of \$603,000 was released to the Port in July 2003, closing the escrow account.

The Port received insurance payments of \$1,279,000 covering certain approved repairs to the Pier 43 arch structure.

**Port Commission
City and County of San Francisco
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Notes to Financial Statements

Note 14 - Commitments, Litigation and Contingencies:

a. Commitments

The Port is presently planning various development projects which involve a commitment to expend significant funds. The Port had firm purchase commitments at June 30, 2004 for approximately \$5,253,000 for capital projects and \$1,527,000 for general operations.

Under an agreement with The San Francisco Bay Conservation and Development Commission finalized in 2001 (The San Francisco Waterfront Special Area Plan), the Port is committed to fund and expend up to \$30 million over a 20 year period for pier removal, parks and plazas and other public access improvements. As of June 30, 2004 \$14.3 million has been appropriated and \$1.6 million has been expended for projects under the agreement. The \$14.3 million in approved appropriations include \$9 million received from the sale of a portion of a seawall lot to a developer. In accordance with the development agreement and the entitlement legislation, these proceeds are restricted for the design and construction of a public plaza required by the Special Area Plan.

b. Litigation

The Port is a defendant in various lawsuits and claims; most deal with personal injury or property damage resulting from accident or fire and are covered by insurance. In the opinion of counsel the likelihood of an unfavorable outcome is probable in some of the suits and, accordingly, accrued liabilities include the aggregate amount of deductibles under applicable insurance policies. However, a number of the lawsuits are in the discovery stages and counsel to the Port cannot express an opinion as to the possible outcome of such litigation. Port's management believes that the ultimate resolution of such matters is not expected to have a material effect on the Port's financial position or results of operations.

c. Contingencies

Risk Management

The Port is subject to various risks of loss including general liability, property and casualty, workers' compensation and employee health and accident. The Port carries commercial insurance for all risks of loss except workers' compensation and employee health and accident. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. The administration of workers' compensation, including estimates of recorded and incurred but not reported claims, is provided by the City. The workers' compensation liability as of June 30, 2004 and 2003 has been evaluated by an independent actuary.

Special Issue: The 2004 American Statistical Association Meeting

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**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

Changes in the reported liability reserves for 2004 and 2003 resulted from the following activity:

	General Liability		Workers' Compensation	
	2004	2003	2004	2003
	(in thousands)			
Beginning of the year	\$ 1,900	\$ 1,600	\$ 2,931	\$ 2,470
Current year claims and changes in estimate	2,265	326	1,122	1,205
Claim payments	(1,878)	(26)	(940)	(744)
End of year	\$ 2,287	\$ 1,900	\$ 3,113	\$ 2,931

The general liability and workers' compensation liability reserves are included in accrued liabilities in the financial statements.

Grants

Certain grants that the Port receives are subject to audit and final acceptance by the granting agency based upon their review of costs incurred. Port's management does not believe that such audits will have a material impact on the financial statements.

Environmental

Port lands are subject to environmental risk elements typical of sites with a mix of light industrial activities dominated by transportation, transportation-related and warehousing activities. Due to the historical placement of fill of varying quality, and widespread use of aboveground and underground tanks and pipelines containing and transporting fuel, elevated levels of petroleum hydrocarbons and lead are commonly found on Port properties. Consequently, any significant construction, excavation or other activity that disturbs soil or fill material may encounter hazardous materials and/or generate hazardous waste.

**Port Commission
City and County of San Francisco
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Notes to Financial Statements

In September 2002, the Port received a notice of violation from the California Department of Toxic Substances Control (DTSC) in connection with the presence of approximately 22,000 tons of soil contaminated with soluble lead at concentrations well below those that would pose a risk of to public health, but at concentrations that classify it as hazardous waste in California. A former tenant operated a soil disposal service and abandoned the contaminated soil after declaring bankruptcy in 1995 and ceased operations in 1996. The tenant was not regulated as a hazardous waste facility. The soil had been tested by the Port to identify potential reuse or disposal options. In January 2003, the Port completed removal of the soil to an appropriate out-of-state landfill with DTSC approval. The total cost of soil removal and related expenses were approximately \$1.6 million.

The Port has identified certain other environmental issues related to Port property, including asbestos removal, fuel tank removal and oil contamination. The Port may be required to perform certain clean up work if it intends to develop or lease the property, or at such time as required by the city or state. The Port projects currently estimable testing and remediation costs to be in the range of \$0.1 million to \$0.9 million of which \$0.5 million is accrued as of June 30, 2004. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for such risk cannot be reasonably made at this time.

The Port has one pier site that is a regulated landfill under a closure order from the California Regional Water Quality Control Board (RWQCB). A revised closure order adopted by the RWQCB in June 2003 requires the Port to conduct limited groundwater monitoring for one year (and quarterly visual inspections thereafter), permits much of the site to remain unpaved, and allows for a broad range of development on portions of the landfill that are currently undeveloped. Site-specific project plans must be reviewed and approved by the RWQCB. The estimated cost to close the landfill site in compliance with the original closure order was previously estimated at \$3.0 million.

PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO

JUNE 30, 2005 AND 2004

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

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**Port Commission
City and County of San Francisco
Port of San Francisco**

**Independent Auditors' Report
and Financial Statements**

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Independent Auditors' Report

THE HONORABLE EDWARD HARRINGTON
CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

We have audited the accompanying balance sheet of the **PORT COMMISSION, CITY AND COUNTY OF SAN FRANCISCO, PORT OF SAN FRANCISCO (the Port)**, an enterprise fund of the City and County of San Francisco, as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Port as of June 30, 2005 and 2004, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 - 11 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Hood & Strong LLP

October 5, 2005

Consultants and

Business Advisors

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San Francisco

Members of the

**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Overview of the Financial Statements

This discussion and analysis is a narrative overview and analysis of the financial activities of the Port of San Francisco (Port). It serves as an introduction to the audited financial statements, which can be found on pages 12 - 37 of this report. This overview should be read in conjunction with the more detailed information contained within the accompanying financial statements.

The Port is a self-supporting enterprise department of the City and County of San Francisco (City) and its financial statements are included in the City's Comprehensive Annual Financial Report. Only the accounts of the Port are included in the financial statements that follow. The Port Commission is responsible for seven and one-half miles of waterfront property, which was transferred in trust from the State of California to the City in 1969. The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations, which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Additional information concerning the Port's organization and the basis of presentation for this financial report is contained in Note 1 to the financial statements (pages 16 - 17).

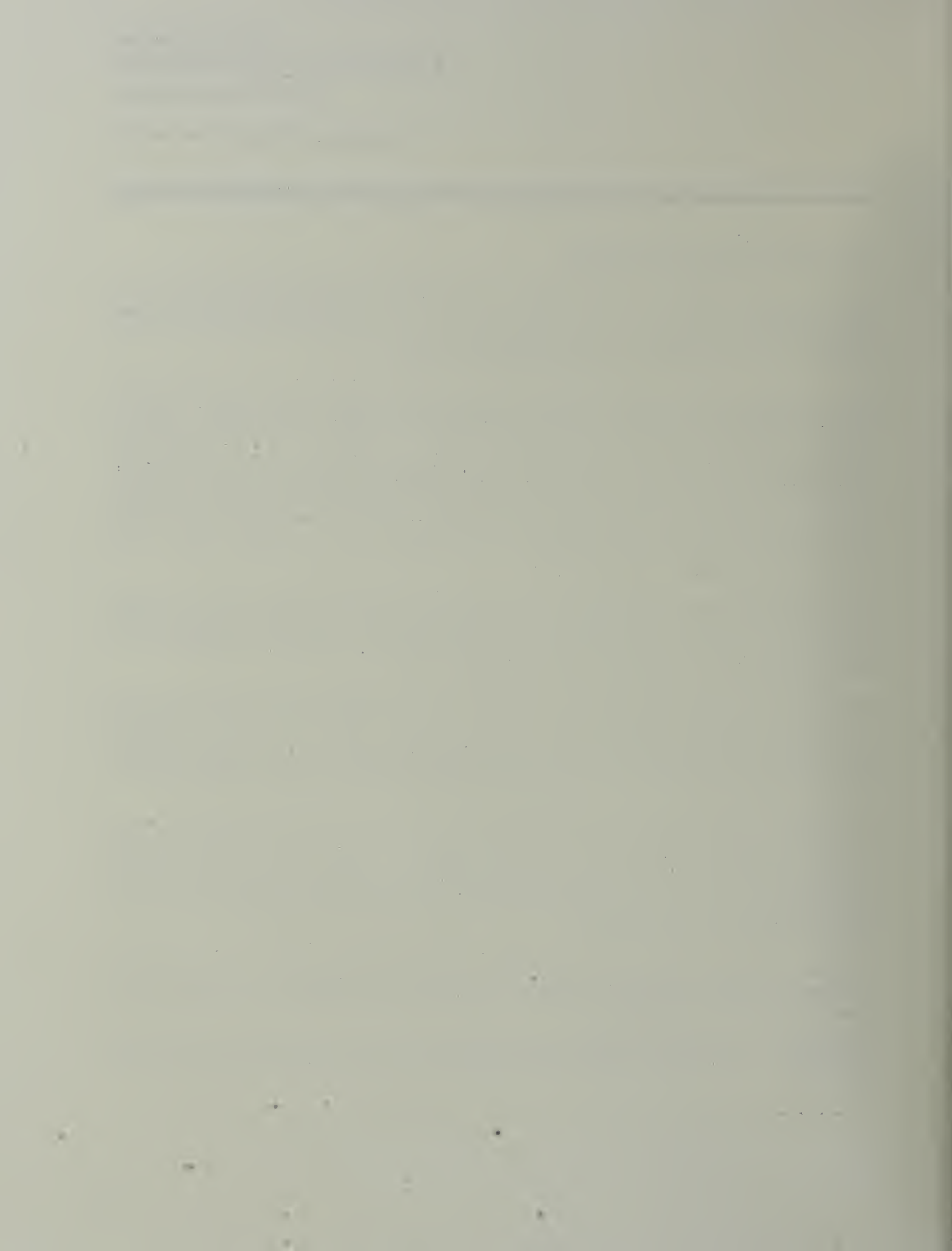
The Balance Sheet presents information on all of the Port's assets and liabilities, with the difference between the two reported as "net assets." Increases and decreases in net assets serve as a useful indicator of the financial position of business enterprise entities like the Port. Comparative information of the Port's financial position is presented as of June 30, 2005 and 2004.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Port's net assets changed during the most recent two fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. uncollected rents from tenants and earned, but unused vacation leave).

The Statement of Cash Flows presents information about the cash receipts and cash payments of the Port during the most recent two fiscal years. This statement shows the effects on financial position of cash and non-cash operating, investing, capital, and financing transactions. When used with related disclosures and information in the other financial statements, the information in the Statement of Cash Flows helps readers assess the Port's ability to generate net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes follow the financial statements and can be found on pages 16 - 37 of this report.

Following is a presentation of certain condensed financial information derived from the basic financial statements.



**Port Commission
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Management's Discussion and Analysis

Condensed Financial Information – Port of San Francisco

Comparative Net Assets (in thousands)

	June 30,			
	2005	2004	Change	% Change
Current and other assets	\$ 88,390	\$ 87,841	\$ 549	0.6
Capital assets	252,971	245,445	7,526	3.1
Total assets	341,361	333,286	8,075	2.4
Long-term debt obligations	22,554	30,382	(7,828)	(25.8)
Other liabilities	21,385	26,944	(5,559)	(20.6)
Total liabilities	43,939	57,326	(13,387)	(23.4)
Net assets:				
Invested in capital assets, net of related debt	236,256	224,407	11,849	5.3
Restricted	21,848	11,190	10,658	95.2
Unrestricted	39,318	40,363	(1,045)	(2.6)
Total net assets	\$ 297,422	\$ 275,960	\$ 21,462	7.8

Changes in Net Assets (in thousands)

	Year Ended June 30,			
	2005	2004	Change	% Change
Revenues:				
Program revenues:				
Rents and other operating revenues	\$ 57,519	\$ 56,702	\$ 817	1.4
Capital grants and other contributions	13,501	2,745	10,756	391.8
General revenues	1,698	1,089	609	55.9
Total revenues	72,718	60,536	12,182	20.1
Total expenses	54,941	61,893	(6,952)	(11.2)
Change in net assets before Special Items	17,777	(1,357)	19,134	(1,410.0)
Special Items	3,685	9,245	(5,560)	(60.1)
Increase in net assets	21,462	7,888	13,574	172.1
Net assets, beginning of the year	275,960	268,072	7,888	2.9
Net assets, end of the year	\$ 297,422	\$ 275,960	\$ 21,462	7.8

**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Financial Analysis

Assets exceeded liabilities by \$297,422,000 at the close of the most recent fiscal year. Total net assets as of June 30, 2005 increased \$21,462,000 from June 30, 2004. This increase follows a \$7,888,000 increase posted for the previous fiscal year. These increases are largely attributed to different nonrecurring revenue and expense transactions occurring in each of these fiscal years. The 2005 results reflect some improvement in Operating Income as well as an increase in non-operating revenues (i.e. grants and other capital contributions). In 2004, the Port closed escrow on a sale of land to a developer and realized a gain of \$9,245,000. Without this special revenue item, total expenses in 2004 exceeded total revenues. The more significant variances and nonrecurring transactions are discussed below in more detail.

The largest portion of the Port's net assets, 79 percent at June 30, 2005 and 81 percent at June 30, 2004, reflects its investment in capital assets (e.g. land, buildings and equipment). The Port is responsible for a seven and one-half mile stretch of waterfront land and its revenue is derived primarily from property rentals to commercial and industrial enterprises and a diverse mix of maritime operations. As disclosed in Note 1 to the financial statements, land transferred from the State of California to the City is reported at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State to reflect appraised values in 1929. The total amount of net assets tied to capital assets (\$236,256,000 at June 30, 2005) represents assets that are not available for future spending. Although the investment in capital assets is reported net of related debt, the resources needed to repay the debt must be provided from other sources (i.e. other Port assets or operating revenues). The capital assets themselves cannot be used to liquidate those liabilities. The remaining portion of net assets at June 30, 2005 consists of \$21,848,000 restricted by current agreements for specified capital expenditures and \$39,318,000 that is unrestricted and available to meet the Port's ongoing obligations and future capital investments.

The Statement of Revenues, Expenses and Changes in Net Assets on page 13 presents the Port's operating revenues in more detail by industry revenue types. Operating revenues for the year ended June 30, 2005 increased \$817,000 or 1.4%. As set forth in Note 9 to the financial statements (page 29), overall property rentals across all revenue types posted a net increase of \$1,475,000 in 2005: \$359,000 from minimum or base rentals and \$1,116,000 from percentage rents over minimum base rents. This latter increase is significant in that the current total percentage (overage) rent level of \$9,200,000 now surpasses that of fiscal 2001 (\$8,542,000) – before the events of September 11, 2001 and a contemporaneous economic downturn. Restaurant and retail sales have strengthened, and Port rents are back at former levels for many of the Port's tenants. Other real estate revenue losses and declines have been more than offset by increases in parking-related revenues. The net decrease in 2005 cargo revenues was principally attributable to the loss of one warehousing customer. Ship repair activity was strong in 2005, yielding a current increase in Port revenue from percentage rent provisions in the dry dock company's lease. Other Maritime revenues were lower in 2005 due to a decrease in lay-berthing activity. Other Operating Revenues include permit fees and various one-time fees realized from major development projects and certain leases on Port property. Such fees were higher in 2004 than in 2005.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

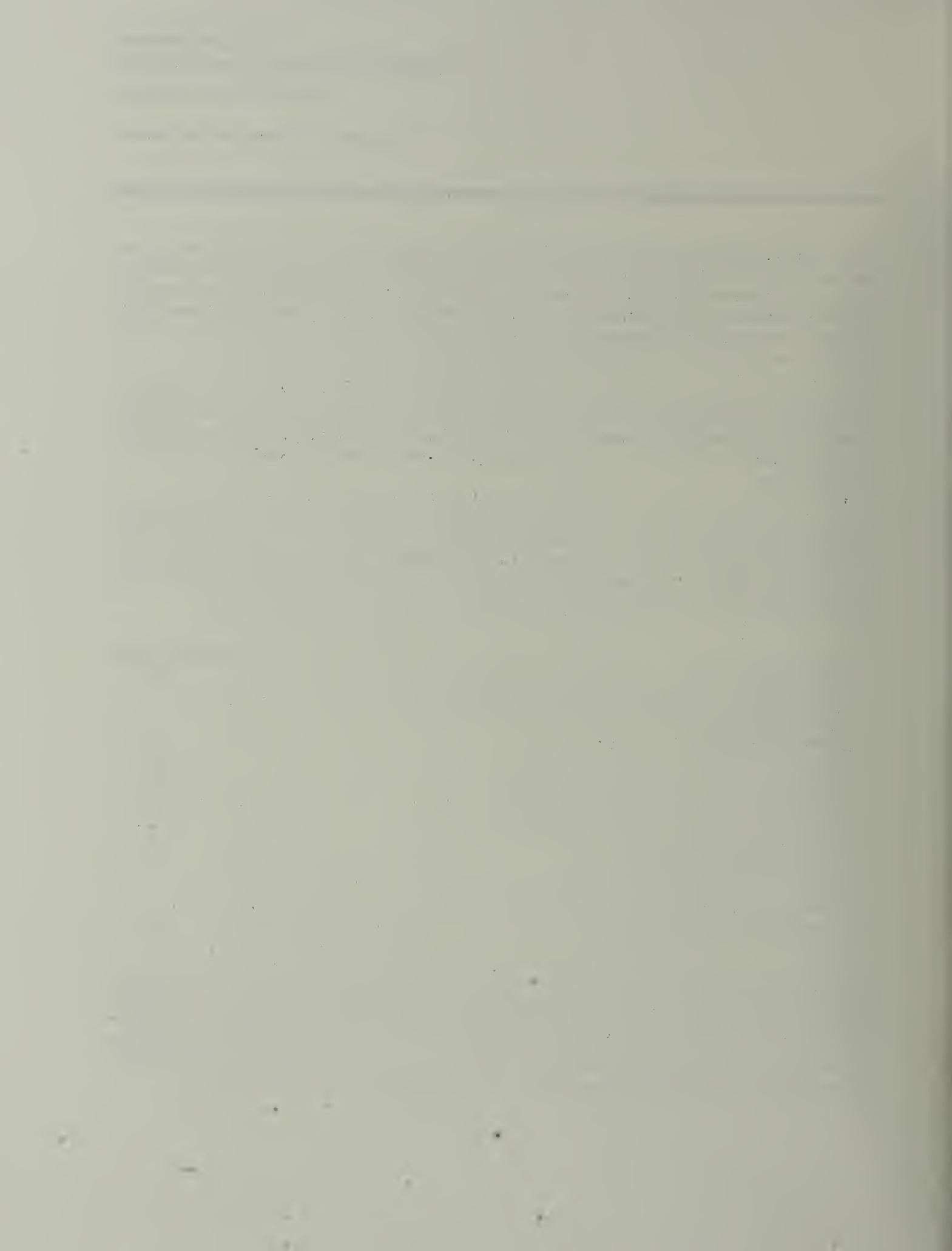
Capital grants and other contributions consist principally of funds received or receivable from federal, state and local grant agencies which provide funding for several of the Port's capital projects. Significant work was in progress during 2005 on security enhancement projects funded by the Transportation Security Administration, Department of Homeland Security (\$3.3 million). Other capital contributions recorded in 2005 include \$4.3 million from a developer and the \$5.0 million value of a surplus dry dock donated to the Port under a conditional transfer arrangement executed in August 1999.

All revenues not reported in the foregoing condensed summaries as Program Revenues, as defined in Government Accounting Standards Board Statement No. 34, are presented as General Revenues. General Revenues for 2005 and 2004 consisted of interest and investment income (\$1,698,000 and \$1,080,000 respectively) and a gain from fire insurance proceeds received for the construction repairs at Pier 43 (\$9,000 in 2004).

Total expenses of \$54,941,000 for 2005 represent a \$6,952,000 decrease from 2004. Comparatively, total expenses for 2004 of \$61,893,000 were a \$1,888,000 decrease from 2003. One-time charges accounted for some of the expense increases in recent years. Other increases occurred in operating cost items like insurance and workers compensation, where management expects some normalization in future periods. The more significant cost and expense changes in 2005 included the following (in thousands):

	<u>Increase/ (decrease)</u>
	<u>\$ (996)</u>
Salary related savings	
Fringe benefit costs, principally due to retirement contribution required beginning 2005	810
Workers compensation	(705)
City service recoveries	(1,443)
Operating subsidy to Pier 80 terminal operator	(1,141)
Dredging costs, largely at Pier 35 East and West	(1,716)
Claims and judgments, largely 2004 settlements	(1,194)
Provision for bad debts	762
Depreciation and amortization	420
Interest savings due to refunded bonds	(787)
Pier removal and loss from asset dispositions (principally removal of Pier 24 in 2004)	(664)

Salary cost savings in 2005 from position reductions, vacancies and normal attrition were substantially offset by a required contribution to the city retirement plan. No employer contribution to the retirement plan was required in 2004. Also in 2005 and 2004, substantially all mandated employee contributions were paid to the retirement system by affected employees (i.e. no "retirement pick-up" expense pursuant to current collectively bargaining agreements – see Note 10 on page 31). Workers compensation benefit payments and the actuarially determined liability reserve requirements were lower for 2005.



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Reimbursement to other city departments for services and expense allocations were approximately \$1,443,000 lower in 2005. In 2004, the Port Commission adopted the findings of a nexus study that analyzed the balance of payments between the Port and City. That study established a record of past expenditures and provides a systematic means for determining the balance of payments for future periods. The 2005 positive expense variance had several components:

- The current year settlement General Fund services was offset by \$277,000 of revenues owed to the Port – also determined pursuant to findings contained in the nexus study.
- The payment to the City in 2004 included a one-time retrospective adjustment for the previous years covered by the nexus study (resulting in year-to-year net change of \$182,000).
- The countywide overhead allocation applicable to the Port for 2005 was a credit adjustment, giving rise to a \$684,000 variance.
- In 2004, the Port funded a departmental performance audit conducted by the Board of Supervisors Budget Analyst (\$300,000).

The management agreement between the Port and its terminal operator at Pier 80 was amended effective January 2005, shifting the entire focus of terminal operations to break bulk cargoes and ending a previous guaranteed compensation arrangement with the terminal operator for operating a container oriented cargo terminal. Break bulk or neo bulk cargo is general, non-containerized cargo, such as steel, lumber and newsprint. This focus on break bulk cargo allows the Port and the terminal operator to significantly reduce staffing, security and utility costs. Under the new operating agreement, terminal revenues are shared between the Port and the terminal operator.

Special Items identify significant transactions or events within the control of management that are either unusual in nature or infrequent in occurrence. In 2001, the Port entered into an agreement giving the San Francisco Municipal Transportation Agency (MUNI) the permanent right to use certain land for its Metro East Maintenance and Operations Facility. MUNI paid a total use fee of \$29,700,000 for these property rights. A portion of the fee (\$4,000,000) was restricted for the construction of a new rail bridge. Construction on the bridge commenced during 2005 and \$3,685,000 of deferred revenue was recognized as of June 30, 2005. In connection with the Piers 30-32 mixed-use cruise terminal development project, and as approved by state legislation in 2001 (Assembly Bill No. 1389), a portion of Seawall Lot No. 330 was sold to a developer in 2004. The land was sold for \$9,324,000; and the Port realized a gain from the sale of \$9,245,000. Certain proceeds from the land sale (\$9,000,000) are restricted for the construction of a public plaza area called Brannan Street Wharf. The remaining proceeds of \$324,000, together with certain residual receipts from the sale of residential condominium units built on the land sold, are restricted for the construction of the cruise terminal.

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Port of San Francisco**

Management's Discussion and Analysis

Capital Asset and Debt Administration

Capital assets. The Port's investment in capital assets as of June 30, 2005 amounts to \$253.0 million, net of accumulated depreciation. This investment in capital assets includes land, certain street and road improvements, pier promenades, pier substructure, buildings and related improvements, vehicles, equipment and furniture. As of June 30, 2005, capital assets, net of depreciation and amortization, increased about three percent from 2004. Additional information on the Port's capital assets can be found in Note 4 on page 22 of this report.

Major capital asset events of fiscal 2005 and 2004 included the following:

- Pursuant to a federally-funded port security program, the Port has opened several capital improvement projects to enhance facility and operational security at the Port's cruise, ferry and cargo facilities. Including costs funded locally, the Port has expended \$4.2 million to date at the Pier 35 cruise passenger terminal. Design has been completed and the contracts awarded for the gate and access control projects at the Downtown Ferry Terminal and the Pier 80 cargo terminal.
- A design-build contract was awarded in November 2003 for the Illinois Street Intermodal Bridge. The bridge will be constructed over Islais Creek and will extend Illinois Street from the north side of the creek, adjacent to the Pier 80 cargo terminal, to Pier 90 on the south side of the creek. Construction of this bridge will provide replacement freight rail service to Pier 80 previously accessed via Potrero Way at 16th Street. The bridge will also provide for two-way truck/vehicular traffic across the bridge, opening of the bridge for watercraft in the creek, and bicycle and pedestrian access across the Bridge. The estimated total project cost is currently \$26.9 million. Construction of the bridge commenced in May 2005.
- Approximately \$1.4 million has been expended toward completion of the Ferry Terminal Public Pier. This project connects the freestanding breakwater at the Downtown Ferry with the Embarcadero Promenade and adds public pedestrian improvements to the top of breakwater. Grant applications are pending for funding of the final phase of this project. Upon completion, pedestrians will be able to walk out over the Bay; fish; view interpretative signage about ferry activities, Bay currents and habitat; observe ferry operations in the adjacent harbor; and enjoy views of the City and the Bay Bridge.
- Since a 1996 fire, a total of \$14.7 million of construction work has been completed at Pier 48. Insurance-funded repair to fire-damaged facilities on the pier and certain seismic repairs to the pier were completed in June 2003. Port-funded electrical service upgrades were completed in November 2003. The pier will return to leasable property inventory after a required CEQA determination process.

At June 30, 2005, \$27 million remain appropriated for capital project related expenditures, including pier repair and major maintenance projects. Port Engineering has been performing facility condition surveys to identify and prioritize required maintenance projects that will preserve and extend the economic life of the Port's productive assets. Development of a ten-year capital plan is in progress. The plan should be completed by March 2006. Preliminary estimates from this capital planning indicate that at least \$1 billion will be needed for major maintenance and capital improvement work on the Port's aging facilities. The planned improvements will bring facilities up to current building code standards, including seismic upgrade or retrofit.

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Management's Discussion and Analysis

Senate Bill No. 1085, signed by the Governor in September 2005, amended the California Government Code to authorize public trust grantees to form infrastructure financing districts pursuant to Section 53395 et seq. The infrastructure district law allows public agencies to finance public infrastructure improvements by capturing and bonding against tax increment generated in the district after it is established. This legislative amendment incorporates changes that enable the City and Port to apply this law to the Port area. Among other things, it authorizes the use of such districts for urban waterfront areas in addition to undeveloped or underdeveloped areas; specifically clarifies that publicly-owned property subject to tidelands trust for commerce, navigation and fisheries (the "public trust"), including filled tidelands, may be included in such districts; and enumerates additional examples of infrastructure improvements that qualify for infrastructure financing districts, including seismic upgrades, historic renovation, environmental remediation, utility improvements, structural repair or construction of seawalls, piers and wharves. A multi-step process must be followed to establish an infrastructure financing district. These steps include defining the boundaries of a district, developing the infrastructure plan and obtaining approval from the Board of Supervisors.

The Port has entered into a number of public/private partnerships with developers for the historical preservation, renovation, and redevelopment of Port properties. Current information concerning major development projects and opportunities can be found at the Port's website: www.sfport.com. Some of the more significant activities and events of 2005 and 2004 include:

Piers 1½ - 5 – The project calls for rehabilitation of historic bulkhead buildings with ground floor restaurants, upper floor office, public access walkways, guest boat docks and a water taxi landing. Construction commenced in April 2004 and completion is anticipated for mid-2006.

Rincon Park Restaurants – Final design for this restaurant development at the south end of Rincon Park along the Embarcadero Promenade is approaching completion and final approval. Construction is expected to commence in 2006.

Bryant Street Piers Mixed Use and Cruise Terminal Development – The project transaction documents were approved by the Port Commission in March 2003 and by the Board of Supervisors in July 2003. The project is planned as a mixed use development with a two-berth cruise ship terminal, ground floor retail and restaurant, and upper floor office and entertainment uses on Piers 30-32. Construction of the cruise terminal is projected to commence in 2007, after other development work. Phase I commenced in March 2004 and entails the construction of a residential condominium tower on a portion of Seawall Lot 330. Completion of Phase I and commencement of construction of a related bayfront urban park on The Embarcadero between Piers 30-32 and Pier 38 ("Brannan Street Wharf") is expected in 2006.

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Management's Discussion and Analysis

Other development projects are in various stages of review and negotiation under exclusive rights (ERN) agreements. These include a mixed-use recreation project at Piers 27-31 (ERN expiring March 2006) and a hotel project at the corner of Broadway and Embarcadero (ERN expiring November 2005). The mixed-use recreation development on a 19-acre complex of historic piers contemplates a new Northeast Wharf Plaza, a new YMCA and Marine Sports Basin, indoor and outdoor recreation as well as offices, restaurants and recreation-oriented retail uses. The hotel project's last design contemplates a first class full-service hotel with 254 rooms, 2 restaurants, meeting rooms and parking garage. The hotel site was re-zoned to a height of 40 feet by an ordinance approved by the Board in June 2005. Consequently, the hotel design is being re-evaluated.

The Exploratorium, a museum of science, art and human perception, is considering leasing and rehabilitating portions of Piers 15-17. The Board of Supervisors passed a resolution in June 2005 exempting the potential lease from the competitive bidding process required by Administrative Code Section 2.6-1. Formal negotiations for this project are pending development of a term sheet and an exclusive-right-to-negotiate agreement.

Development and planning activities are also being directed at master planning for the Pier 70 Opportunity Area and preliminary feasibility analyses for environmental, engineering and economic viability of development in the Piers 90-94 Backlands.

Long-term obligations. Detailed information concerning the Port's long-term obligations can be found in Note 8 on pages 25 - 29 of this report. As of June 30, 2005, the Port had total long-term obligations of \$22,554,000, including \$3,470,000 that will mature during the next fiscal year. The last series of 1971 Harbor Improvement general obligation bonds matured in 2005. The remaining debt includes \$19,195,000 in revenue bonds and \$3,359,000 in loans that are secured by specified revenue sources. As discussed in Note 8, the Port issued new refunding revenue bonds in August 2004 to current refund the outstanding Series 1994 Revenue Bonds. The term of the bonds was not extended. The current refunding was completed to take advantage of lower interest rates, reducing total debt service over the next five years. No other debt was issued during the years ended June 30, 2005 and 2004.

Economic and Other Factors

Economy. In recent years, uncertainties concerning the general national and local economic condition as well as the terrorism actions of September 11, 2001, negatively affected tourist travel and tourist-dependent sales venues in the City. After an extended period of reduced patronage, the Port's restaurant and retail tenants in the aggregate have reported progressively stronger sales activity in the last two years. While the Port's operating results for fiscal year 2004-05 reflect a solid recovery, the economic climate remains uncertain. Economic recovery has been fairly slow and new challenges are arising in 2005 with rising fuel costs and the further disruption of oil supplies by recent weather-related disasters in the Gulf coast region. Port and City managers will closely monitor revenue streams and expense trends. General economic conditions are taken into consideration when preparing Port budgets and forecasts.

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Management's Discussion and Analysis

The Port currently expects, in the aggregate, to be able to maintain revenues at current levels with modest year-to-year growth. As is standard with retail leases, a minimum fixed rent is paid to the Port at the beginning of every month. The Port has been able to maintain a fixed rent roll at approximately \$3.3 million per month and most of the Port's property rentals are covered by term leases. Note 9 (page 30) contains required financial statement disclosure information covering the future rental income stream from minimum rents over the noncancellable term of active operating leases. Revenue loss to the Port during down periods is generally limited to some decline in overage rents (percentage rents above the minimum) and increased delinquencies.

San Francisco Waterfront Special Area Plan. In July 2000, the Port agreed to amend its Waterfront Land Use Plan, and the San Francisco Bay Conservation and Development Commission (BCDC) its San Francisco Bay Plan to create consistent plans for the waterfront area between the Hyde Street Pier and China Basin (San Francisco Waterfront Special Area Plan). Among other things, the Special Area Plan commits the Port to expend up to \$30 million over a 20-year period for the removal of certain piers and the construction of major public plazas and other public access improvements. The Port is aggressively seeking other funding sources (i.e. grants and contributions) to finance the required pier removals and public access improvements. Until sufficient funding from other sources is secured, the Port must commit significant capital funds for the Special Area Plan projects. As of June 30, 2005, \$16.5 million has been appropriated and \$1.6 million has been expended for projects under the agreement.

Assembly Bill No. 1389, signed by the Governor of California in October 2001 to authorize approval of the development plans for a cruise ship terminal at Piers 30-32, also ratifies the San Francisco Waterfront Special Area Plan adopted by the Port and BCDC. Among other things, the legislation accelerated a requirement for the construction of one public plaza area, the Brannan Street Wharf. Construction of the estimated \$15 million plaza project is anticipated to commence in 2006.

Port security. The Port participates in a regional Port Security Committee, which reviews security issues and needs affecting ports and terminals in the San Francisco Bay Area. In June 2005, the Port hired a full-time homeland security manager – consolidating security and emergency preparedness functions variously covered by other employees. This position is responsible for developing, directing, overseeing and implementing a comprehensive security program mandated by the federal government.

Under the Port Security Grants Program, managed by the Transportation Security Administration (Department of Homeland Security), the Port of San Francisco received a first round grant to conduct a comprehensive security assessment study of its waterfront facilities. Subsequently, the Port was awarded a total of \$3.9 million in second and third round funding for certain capital improvements that improve facility and operational security at the Port's cruise, ferry and cargo facilities.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Requests for Information

This report is designed to provide a general overview of the Port of San Francisco's finances. The financial statements and related informative disclosures in the notes to the financial statements and required supplementary information is presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Public Information Officer or the Fiscal Officer at Port of San Francisco, Pier 1, San Francisco, California, 94111.

Questions concerning the City and County of San Francisco or requests for a copy of the City's Comprehensive Annual Report should be addressed to: Office of the Controller, City and County of San Francisco, at City Hall, Room 316, #1 Dr. Carlton B. Goodlett Place, San Francisco, CA 94102-4694.

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Balance Sheet
(in thousands)**

<i>June 30,</i>	2005	2004
Assets		
Current Assets:		
Cash and investments, held in City Treasury - Port operating fund	\$ 66,096	\$ 60,777
Cash outside of City Treasury	5	5
Receivables - net	5,410	4,618
Materials and supplies	1,174	1,270
Prepaid insurance and other assets	581	697
Total current assets	73,266	67,367
Restricted Assets:		
Cash held in City Treasury:		
Lessee deposits	3,752	3,506
Capital outlay	592	636
Bond interest and redemption held by trustee	6,294	10,060
Other - Lessee deposits	767	742
Total restricted assets	11,405	14,944
Capital Assets - net	252,971	245,445
Other Assets	3,719	5,530
Total assets	\$ 341,361	\$ 333,286
Liabilities		
Current Liabilities Payable from Current Assets:		
Accounts payable and accrued liabilities	\$ 9,756	\$ 14,212
Current maturities of long-term obligations	80	500
Accrued interest payable	139	144
Total current liabilities	9,975	14,856
Current Liabilities Payable from Restricted Assets:		
Current maturities of revenue bonds	3,390	3,920
Accrued bond interest payable	302	779
Lessee deposits	4,519	4,248
Deferred grants	154	145
Total payable from restricted assets	8,365	9,092
Noncurrent Liabilities	3,719	4,512
Deferred Revenue - Net of current portion	2,796	2,904
Long-term Obligations - Net of current maturities	19,084	25,962
Total liabilities	43,939	57,326
Net Assets:		
Invested in capital assets, net of related debt	236,256	224,407
Restricted	21,848	11,190
Unrestricted	39,318	40,363
Total net assets	297,422	275,960
Total liabilities and net assets	\$ 341,361	\$ 333,286

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Statement of Revenues, Expenses and Changes in Net Assets
(in thousands)**

<i>Years Ended June 30,</i>	2005	2004
Operating Revenues:		
Commercial and industrial	\$ 34,791	\$ 33,489
Parking	8,600	8,154
Cargo	5,277	5,561
Fishing	1,520	1,454
Ship repair	1,021	867
Harbor services	997	991
Cruise	1,679	1,578
Other maritime	1,206	1,319
Other	2,428	3,289
Total operating revenues	57,519	56,702
Operating Expenses:		
Operations and maintenance	43,786	49,707
Depreciation and amortization	9,967	9,547
Total operating expenses	53,753	59,254
Operating income (loss)	3,766	(2,552)
Other Income (Expense):		
Interest and investment income	1,698	1,080
Interest expense	(1,144)	(1,931)
Gain from fire insurance settlement		9
Loss from disposition of assets	(44)	(708)
Total nonoperating revenues and expenses	510	(1,550)
Capital Contributions - Capital grants and other contributions	13,501	2,745
Special Items:		
Use fee for property rights in perpetuity	3,685	
Gain from sale of land to a developer		9,245
Change in Net Assets	21,462	7,888
Net Assets - beginning of the year	275,960	268,072
Net Assets - end of the year	\$ 297,422	\$ 275,960



9 December 2005

Librarian
San Francisco Public Library
100 Larkin St., Civic Center
San Francisco, CA 20233

Dear :

Enclosed for your information are the Financial Statements and Independent Auditor's Report for the Port of San Francisco for the fiscal years ended June 30, 2004 and 2005. I am pleased to report an increase in the Port's net assets of \$21.4 million for the fiscal year ended June 30, 2005.

Revenue bond coverage on the Port Commission Revenue Refunding Bonds was 3.63x for fiscal year 2005 and 2.15x for fiscal year 2004; computed as follows:

<u>(\$ in Thousands)</u>	Fiscal Year Ended	
	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Revenues		
Maritime	\$11,865	\$12,192
Real Estate & Asset Management	43,699	41,955
Interest Income ¹	1,603	1,027
Other Operating Revenue ²	<u>1,945</u>	<u>2,358</u>
Total Revenues	\$59,112	\$57,532
Operations & Maintenance Expense ³	(\$41,210)	(\$46,081)
Net Revenues	\$17,902	\$11,451
Debt Service	\$4,932	\$5,314
Debt Service Coverage Ratio	3.63x	2.15x

1. Interest income from funds on deposit with the City Treasury plus late charges from tenants.
2. Excludes \$177,965 in grants for operating activities for fiscal year 2004.
3. Excludes amortized dredging costs.

If you have any questions about the financial statements, or the debt service coverage calculation, please contact Lawrence Brown at (415) 274-0446.

Sincerely,

Tina Olson
Director, Finance and Administration

encl:

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Statement of Cash Flows
(in thousands)**

<i>Years Ended June 30,</i>	2005	2004
Cash Flows from Operating Activities:		
Cash received from tenants for rent	\$ 46,760	\$ 45,887
Cash received from customers and others	8,818	8,020
Deposits received from tenants and customers	572	428
Cash paid to employees for services	(19,575)	(20,582)
Cash paid to suppliers for goods and services	(12,529)	(11,915)
Cash paid for quasi-external transactions	(9,615)	(11,180)
Customer deposits returned	(326)	(114)
Net cash provided by operating activities	14,105	10,544
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment	(10,554)	(7,706)
Dredging	(1,020)	(1,631)
Proceeds from Revenue Refunding Bonds, Series 2004	20,311	
Payments of long-term debt, including defeasance of 1994 bonds	(28,058)	(4,103)
Interest payments on long-term debt	(1,386)	(1,930)
Bond issue costs	(308)	
Capital grants received	2,404	2,427
Contributed capital other than grants	4,650	
Net insurance proceeds from fire casualties		429
Proceeds from sale of equipment and materials	113	25
Pier demolition and other asset disposition costs	(34)	(676)
Proceeds from sale of land		9,000
Net cash used by capital and related financing activities	(13,882)	(4,165)
Cash Flows from Investing Activities:		
Interest income received	1,586	1,834
Investments purchased by Trustee	(2,018)	
Net cash provided by investing activities	(432)	1,834
Net Increase (Decrease) in Cash and Cash Equivalents	(209)	8,213
Cash and Cash Equivalents - Beginning of year	74,931	66,718
Cash and Cash Equivalents - End of year	\$ 74,722	\$ 74,931

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Statement of Cash Flows (In Thousands)
(Continued)**

<i>Years Ended June 30,</i>	2005	2004
Noncash Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment included in accounts payable and accrued liabilities	\$ 2,313	\$ 363
Surplus dry dock donated to Port	5,000	
Loss on abandonment of property and equipment	11	39
Noncash Investing Activities:		
Change in fair value of cash and investments held in City Treasury	\$ (22)	\$ (506)
Change in fair value of U.S. Treasury Note held by bond trustee	(32)	
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income (loss)	\$ 3,766	\$ (2,552)
Adjustment to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation and amortization	9,967	9,547
Change in allowance for doubtful accounts	918	(966)
Net change in deferred revenue	(366)	(661)
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables	(201)	284
Materials and supplies	96	(77)
Prepaid insurance and other assets	2,935	5,056
Increase (decrease) in:		
Accounts payable and accrued liabilities	(3,256)	(401)
Lessee deposits	246	314
Net cash provided by operating activities	\$ 14,105	\$ 10,544
Reconciliation of Cash and Cash Equivalents to the Balance Sheet:		
Cash and investments held in City Treasury - Port operating fund	\$ 66,096	\$ 60,777
Cash deposit outside of City Treasury	5	5
Cash held in City Treasury:		
Lessee deposits	3,752	3,506
Capital outlay	592	636
Cash held by Trustee - Bond interest and redemption (see Note 2)	4,308	10,060
	74,753	74,984
Change in fair value of cash and investments held in City Treasury	(31)	(53)
Cash and Cash Equivalents	\$ 74,722	\$ 74,931

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

Note 1 - Significant Accounting Policies:

a. Basis of Presentation

The Port of San Francisco (Port) is an enterprise fund of the City and County of San Francisco (City). Only the accounts of the Port are included in these financial statements. There are no component units that should be considered for inclusion in the Port's financial reporting entity.

A five-member Port Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for fixed terms of four years. The Port is an integral part of the City, and the accompanying financial statements are included in the City's Comprehensive Annual Financial Report.

Prior to February 1969, the Port was owned by the State of California ("State") and administered by the San Francisco Port Authority, a State agency. In February 1969, the State transferred the Port in trust to the City under the terms and conditions specified in the State statutes of 1968, Chapter 1333 ("Burton Act"), as amended, and ratified by the City's voters in November 1968.

Under the terms of the Burton Act, the State Legislature reserved the right to amend, modify, or revoke, in whole or in part, the transfer of lands in trust, provided that the State would then assume all lawful obligations related to such lands.

The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Substantially all of the Port's property rental customers are located within the boundaries of the City.

The Port's financial statements are prepared using the economic resources measurement focus and the accrual basis in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). In addition, the Port applies all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred.

**Port Commission
City and County of San Francisco
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Notes to Financial Statements

In accordance with GASB Statement No. 34 (GASB 34) “Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments,” the balance sheet presents the difference between assets and liabilities as net assets. Net assets are reported in three broad components, as applicable – invested in capital assets, net of related debt; restricted; and unrestricted. Under the all-inclusive approach to presenting the changes in net assets, all Port revenues, including capital contributions, are reported in the statement of revenues, expenses and changes in net assets.

b. Cash and Investments

The Port reports its investments at fair value based upon quoted market prices. Fair value is defined as the amount that the Port could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short term investments are reported at cost (or amortized cost), which approximates fair value. For purposes of the statement of cash flows, all unrestricted and restricted cash and highly liquid investments with maturities of three months or less, when purchased, are considered to be cash equivalents. In addition, the Port considers its deposits with the City Treasurer (see Note 2) to be demand deposits and therefore cash for the purposes of the statement of cash flows.

c. Materials and Supplies

Materials and supplies are used for construction and maintenance of Port facilities and are stated at average cost.

d. Restricted Assets

Cash security deposits received by the Port pursuant to lease agreements are held in the City Treasury. Other lessee deposits are renewable certificates of deposit tendered by tenants in lieu of cash and held by banks as third-party certificates in the name of the Port. Other lessee deposits also include deposits receivable pursuant to adjustment provisions in the leases.

Bond interest and redemption represent funds accumulated for debt service payments due in the next twelve months and reserve funds set aside to make up potential future deficiencies. A bond trustee holds these funds.

Capital outlay funds are restricted for use in construction and acquisition of equipment, due to restrictions from federal and state grant agreements and bond resolutions.

e. Capital Assets

Land transferred to the City in February 1969 is stated at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State in prior years to reflect appraised values in 1929.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

Other capital assets are carried at cost or at fair market value at the date received in the case of property received by donation or by termination of a lease. Donated surplus equipment received from the federal government is carried at an estimated value determined in accordance with federal guidelines. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets. Land improvements (principally pavement and pier promenades) with a cost of approximately \$19 million are not depreciated because, in the opinion of management, the assets will be maintained to provide indefinite useful lives. Building (tenant) improvements are amortized using the straight-line method over the shorter of the estimated life of the asset or the remaining term of the related lease. Maintenance and repairs are expensed as incurred.

Interest paid on bond funds used for construction purposes, less interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, if applicable, is capitalized from the date of borrowing through the construction period.

f. Other Assets

Bond issue costs are amortized using the straight-line method over the life of the bond. Original bond issue premiums are offset against the related debt and amortized using the straight-line method over the life of the bonds.

Dredging costs are amortized using the straight-line method over the estimated useful period ranging from one to seven years.

Waterfront Land Use Plan (Plan) costs are amortized using the straight-line method over an estimated life of 20 years. The Plan was approved by the City Board of Supervisors in September 1997.

g. Deferred Revenue

Deferred revenue consists primarily of rent credits issued to customers. Deferred revenue is recognized in accordance with the lease agreements and is amortized using the straight-line method over the term of the specific leases.

h. Refunding Debt

The Port's 1994 revenue refunding bonds were current refunded in August 2004 (see Note 8). The difference between the reacquisition price and the net carrying amount of the old debt is deferred and together with the unamortized difference from the 1994 refunding is reported as a reduction of the bonds payable. The total deferred amount is being amortized on a straight-line basis over the remaining life of the bonds through 2010.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

i. Operating Revenues and Expenses

The Port distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from the real estate, maritime and other principal ongoing activities of the Port's normal business operations. Real estate revenues consist principally of rentals of Port property to industrial, commercial, retail, office and other business enterprises. Maritime revenues are derived from vessel operations, warehousing, ship repair, harbor services and other maritime activities. Vessel operations include dry and liquid bulk, break bulk and container cargoes, cruise, and other berthing. Other operating revenues include building permit and inspections fees. Operating expenses include facility maintenance, the cost of operations, administrative expenses and depreciation and amortization on capital assets. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

j. Capital Contributions

The Port, at various times, receives federal and state grants and other funds from external sources for construction of waterfront facilities. The funds are reported as capital contributions on the Statement of Revenues, Expenses and Changes in Net Assets.

k. Environmental Expenses

The Port incurs costs associated with environmental clean-up which arise during the normal course of business. These costs are recorded as a liability when the Port is required to perform the clean-up. Environmental liabilities are accrued when it is probable that obligations have been incurred and the associated amounts can be reasonably estimated.

l. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

Note 2 - Cash and Investments:

The Port maintains its operating fund cash and investments and a portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The Comprehensive Annual Financial Report of the City provides more detailed information concerning deposit and investment risks associated with the City's pool of cash and investments at June 30, 2005.

The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer, subject to review by the Treasury Oversight Committee. The Treasury Oversight Committee, established under California Government Code Sections 27130 to 27137, is composed of various City officials and representatives of agencies with large cash balances. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. Its provisions address interest rate risk, credit risk and concentration of credit risk and provides for additional restrictions related to investments. The policy specifies authorized investment types and sets parameters for maximum maturity, maximum percentage of the total portfolio which may be invested in specific investment types, and maximum investment to one issuer for certain investment types. Investments in the City's pool include investments that are insured or registered or securities held by the City or its agent in the City's name. The City's pool is not registered with the SEC as an investment company and is not rated.

The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging authorized securities as collateral. The fair value of pledged securities must equal at least 110 percent of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2005, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

The Port's cash and investments, reported at fair value, at June 30, 2005 and 2004 are as follows:

	2005	2004
	(in thousands)	
Cash and investments in City treasury	\$ 66,096	\$ 60,777
Cash outside of City treasury	5	5
Restricted assets:		
Cash and investments in City treasury	4,344	4,142
Deposits and investments outside City treasury:		
Cash and investments held by bond trustee	6,294	10,060
Lessee deposits	618	636
	<u>\$ 77,357</u>	<u>\$ 75,620</u>

Lessee security deposits are held on behalf of the Port by third party trustees and invested in renewable certificates of deposit. These deposits, made by tenants and customers directly to banks, are held outside of the City Treasury and are not collateralized as public agency deposits. One uncollateralized account for \$167,000 exceeds the federal insurance limit.

At June 30, 2005 and 2004, cash and investments held in reserve and for debt service payments by trustee consist of:

	2005	2004
	(in thousands)	
Reserve Fund:		
U.S. Treasury Money Fund	\$ 37	\$ 5,361
U.S. Treasury Note, due June 15, 2009	1,986	
Debt Service Funds:		
U.S. Treasury Money Fund	4,271	4,699
	<u>\$ 6,294</u>	<u>\$ 10,060</u>

Investment of all funds and accounts held by the bond trustee are governed by the Bond Indenture rather than the general provisions of the California Government Code or the City's investment policy. As permitted by the Indenture, investments held by the bond trustee consist of a single U.S. Treasury note maturing in 2009 in the Reserve Fund and shares of a registered money market fund. Although other investment types are permitted by the Indenture, their use is not anticipated. The money market fund has a Standard & Poor's rating of AAAm.

**Port Commission
City and County of San Francisco
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Notes to Financial Statements

Note 3 - Receivables:

At June 30, 2005 and 2004, receivables consisted of:

	2005	2004
	(in thousands)	
Trade accounts receivable	\$ 4,906	\$ 3,941
Less allowance for doubtful accounts	(1,702)	(784)
	3,204	3,157
Grants receivable	1,906	468
Insurance proceeds receivable		750
Accrued interest receivable	289	123
Other	11	120
	\$ 5,410	\$ 4,618

Note 4 - Capital Assets:

At June 30, 2005 and 2004, capital assets consisted of:

	2005	2004	Estimated Useful Life (Years)
	(in thousands)		
Land and land improvements	\$ 119,452	\$ 119,452	
Buildings, structures and related improvements	273,279	265,826	5 - 64
Furniture, machinery and equipment	13,477	13,368	2 - 20
Total	406,208	398,646	
Less accumulated depreciation	(173,631)	(165,257)	
	232,577	233,389	
Construction work in progress	20,394	12,056	
Total	\$ 252,971	\$ 245,445	

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Notes to Financial Statements

Total interest cost was \$905,000 and \$1,764,000 for fiscal years 2005 and 2004. Total interest earned was \$1,720,000 and \$1,585,000 for fiscal years 2005 and 2004. No interest cost and earnings were capitalized in 2005 and 2004.

The buildings, structures and improvements identified above include pier substructures, which have an estimated useful life greater than 50 years. Such long-lived assets total \$21,915,000 as of June 30, 2005 and 2004.

The cost of fully depreciated assets still in use was approximately \$85,796,000 at June 30, 2005, including \$81,137,000 in buildings, structures and improvements and \$4,659,000 in furniture, machinery and equipment.

The following is a summary of changes in capital assets for the year ended June 30, 2005 (in thousands):

	Balance June 30, 2004	Increases	Decreases	Balance June 30, 2005
Land and land improvements	\$ 119,452	\$ -	\$ -	\$ 119,452
Buildings, structures and related improvements	265,826	8,243	790	273,279
Furniture, machinery and equipment	13,368	921	812	13,477
Total	398,646	9,164	1,602	406,208
Construction in progress	12,056	12,250	3,912	20,394
	410,702	21,414	5,514	426,602
Less accumulated depreciation for:				
Buildings, structures and related improvements	157,300	8,963	790	165,473
Furniture, machinery and equipment	7,957	1,003	802	8,158
Total accumulated depreciation	165,257	9,966	1,592	173,631
Total	\$ 245,445	\$ 11,448	\$ 3,922	\$ 252,971

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Notes to Financial Statements

Note 5 - Other Assets:

Other assets at June 30, 2005 and 2004, net of related amortization, consisted of:

	2005	2004
	(in thousands)	
Deferred debt	\$ 252	\$ 264
Dredging costs	986	2,612
Waterfront land use plan	2,020	2,185
Note receivable from land sale	324	324
Other deferred costs	137	145
	<u>\$ 3,719</u>	<u>\$ 5,530</u>

The note receivable of \$324,000 is the deferred portion of the \$9,324,000 total purchase price for land sold to a developer in 2004. The Port realized a gain of \$9,245,000 from this sale of land. The deferred amount plus interest is payable to the Port from certain residual receipts derived from the developer's future sale of residential condominium units built on the land sold. Interest on the note accrues at the prime or reference rate of a bank plus two percent (8.25% at June 30, 2005 and 6.25% at June 30, 2004).

Note 6 - Accounts Payable and Accrued Liabilities:

At June 30, 2005 and 2004, accounts payable and accrued liabilities consisted of:

	2005	2004
	(in thousands)	
Accounts payable	\$ 3,971	\$ 2,770
Due to City General Fund		598
Current portion of deferred revenue	622	4,565
Accrued liabilities	3,487	4,591
Accrued payroll, compensated absences and related costs	1,676	1,688
	<u>\$ 9,756</u>	<u>\$ 14,212</u>

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Notes to Financial Statements

Note 7 - Noncurrent Liabilities:

At June 30, 2005 and 2004, noncurrent liabilities consisted of:

	2005	2004
	(in thousands)	
Compensated absences and related costs	\$ 770	\$ 849
Workers' compensation	2,179	2,463
Litigation, claims and judgments	770	1,200
	<u>\$ 3,719</u>	<u>\$ 4,512</u>

Note 8 - Long-Term Obligations:

Long-term obligations at June 30, 2005 and 2004 consisted of the following:

	Interest Rate (%)	Fiscal Year Last Series Matures	Balance 2005	2004
			(in thousands)	
Revenue bonds	2.25 - 5.80	2010	\$ 19,195	\$ 26,523
General obligation bonds	6.30	2005		400
Loan payable	4.50	2029	3,359	3,436
Capital lease	6.31	2005		23
Total long-term obligations			22,554	30,382
Less current maturities			(3,470)	(4,420)
Net long-term obligations			<u>\$ 19,084</u>	<u>\$ 25,962</u>

**Port Commission
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Notes to Financial Statements

The following is a summary of changes in long-term obligations for the years ended June 30, 2005 and 2004 (in thousands):

	Revenue Bonds	General Obligation Bonds	Loans	Capital Lease	Total
Balances as of June 30, 2003	\$ 30,004	\$ 800	\$ 3,510	\$ 68	\$ 34,382
Current maturities, retirements and other decreases	(3,481)	(400)	(74)	(45)	(4,000)
Balances as of June 30, 2004	26,523	400	3,436	23	30,382
Current maturities, retirements and other decreases, net	(7,328)	(400)	(77)	(23)	(7,828)
Balances as of June 30, 2005	\$ 19,195	\$ -	\$ 3,359	\$ -	\$ 22,554

The annual payments required for all outstanding long-term obligations are as follows (in thousands):

	Revenue Bonds		Other Long Term Obligations		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
<u>Year Ending June 30:</u>						
2006	\$ 3,390	\$ 554	\$ 80	\$ 151	\$ 3,470	\$ 705
2007	3,975	453	84	148	4,059	601
2008	4,070	348	88	144	4,158	492
2009	4,185	222	92	140	4,277	362
2010	4,320	75	96	136	4,416	211
2011 – 2015			549	609	549	609
2016 – 2020			685	474	685	474
2021 – 2025			853	305	853	305
2026 – 2029			832	95	832	95
Total	\$ 19,940	\$ 1,652	\$ 3,359	\$ 2,202	\$ 23,299	\$ 3,854

**Port Commission
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Notes to Financial Statements

Bonds

Bond obligations at June 30, 2005 and 2004 consisted of the following:

	Interest Rate (%)	Fiscal Year Last Series Matures	Balance	
			2005 (in thousands)	2004
General Obligation Bonds:				
City and County of San Francisco - Harbor Improvement 1971, Series B	6.30	2005	\$	400
Total General Obligation Bonds				400
Revenue Bonds:				
Series 1994	5.50 - 9.00	2010		27,095
Series 2004	2.25 - 4.00	2010	\$ 19,940	
Total Revenue Bonds			19,940	27,095
Total Bond Obligations			19,940	27,495
Less:				
Current maturities			(3,390)	(4,320)
Unamortized bond premium			303	216
Deferred amount on refunding			(1,048)	(788)
Net Bond Obligations			\$ 15,805	\$ 22,603

In August 2004, the Port issued \$19,940,000 in Revenue Refunding Bonds, Series 2004 with an average interest rate of 3.16% to current refund \$23,175,000 of outstanding Series 1994 Revenue Bonds with an average coupon rate of 5.84%. Net proceeds from the new bonds plus an additional \$3.9 million of Series 1994 debt service monies were used to defease the 1994 bonds. The Port completed the current refunding to reduce its total debt service payments over the next five years by \$1.6 million and to obtain an economic gain (difference between the present value of the old and new debt service payments) of \$1.2 million. The 1994 bonds refunded \$49,975,000 of outstanding 1984 Revenue Bonds, Series A, B and C with an average interest rate of 8.4 percent.

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Notes to Financial Statements

The refunding resulted in a difference between the reacquisition price (principal of the old debt plus 2% call premium) and the net carrying amount of the old debt of \$0.5 million. The previous 1994 refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$2.36 million. The total difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the fiscal year 2010 using the straight line method.

The revenue bonds are secured by a pledge of Net Revenues of the Port, as defined by the Revenue Bond Indenture. Under the terms of the Indenture, as amended, the Port is required to deposit with a trustee in a reserve fund, an amount equal to the lesser of (a) maximum debt service accruing in any year during the life of such bonds, (b) ten percent (10%) of the proceeds derived from the sale of Series 2004 Bonds, or (c) 1.25 times the average annual debt service due with respect to Series 2004 Bonds. At June 30, 2005, the Port was required to have \$2,031,000 in the reserve fund, which amount was \$8,000 greater than the fair value of the investment assets held in the fund. Subsequent to June 30, 2005, the trustee transferred sufficient funds from the debt service fund to the reserve fund to comply with this Indenture requirement. Prior to June 30, 2005, the trustee had transferred certain interest earnings from the reserve fund to the interest debt service fund. The \$4,271,000 held in debt service funds at June 30, 2005 exceeded July 1, 2005 debt service payments by \$130,000.

While Series 2004 Bonds are outstanding, the Port may not create liens on its property essential to operations, dispose of any property essential to maintaining revenues or operating the Port, and must maintain specified insurance. The Port may issue additional bonds under the Indenture provided the Port complies with the Additional Bonds Test, as defined in the indenture.

Covenants of the Indenture, as amended, include that the Port will maintain its business operations, and establish, and maintain rentals, rates, fees, and charges for the use of Port property and for services rendered by the Port so that the Net Revenue, as defined in the bond indenture, in each fiscal year will be at least equal to 130% of aggregate annual debt service for such fiscal year. At June 30, 2005, the Port was in compliance with such bond covenants.

The Series 2004 Revenue Bonds are subject to an arbitrage rebate requirement. The requirements stipulate, in general, that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The cumulative arbitrage liability as of June 30, 2005 was approximately \$11,000.

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Notes to Financial Statements

Loans

The Port has entered into a loan agreement with the California Department of Boating and Waterways (Cal Boating) for \$3.5 million to finance a certain capital project. The loan is subordinate to all bonds payable by the Port. Interest accrues at a rate of 4.5% per annum on the unpaid balance commencing with the first draw on the loan. The term is 30 years from the date of the first draw, which occurred in April 1998. The loan is secured by Gross Revenues as defined in the loan agreement. The project was completed as scheduled in 2002 and annual payments commenced on August 1, 2002.

	2005	2004
	(in thousands)	
Loan payable to Cal Boating	\$ 3,359	\$ 3,436
Less current portion	(80)	(77)
<u>Net loan payable</u>	<u>\$ 3,279</u>	<u>\$ 3,359</u>

Capital Lease

In 1999, the Port entered into a five-year lease purchase agreement for certain equipment. This lease arrangement is accounted for as a capital lease. At June 30, 2005, equipment under this lease arrangement totaled approximately \$200,000 and accumulated amortization on those assets at June 30, 2005 and 2004 totaled \$156,000 and \$134,000, respectively.

Note 9 - Operating Revenues - Property Rentals:

Certain property rental agreements specify rental payments based on a percentage of tenant sales, subject to a minimum amount. Property rental revenues were comprised as follows:

	2005	2004
	(in thousands)	
Minimum rentals	\$ 38,852	\$ 38,493
Percentage rentals	9,200	8,084
	<u>\$ 48,052</u>	<u>\$ 46,577</u>

**Port Commission
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Notes to Financial Statements

Minimum future rental income under noncancellable operating leases having terms in excess of one year are as follows:

<u>Year Ending June 30</u>	(in thousands)
2006	\$ 25,379
2007	22,951
2008	21,311
2009	19,593
2010	17,161
2011 - 2015	76,230
2016 - 2020	63,890
2021 - 2025	54,080
2026 - 2030	45,230
2031 - 2035	42,800
2036 - 2040	33,473
2041 - 2045	21,142
2046 - 2050	16,678
2051 - 2055	7,197
2056 - 2060	7,000
2061 - 2065	7,000
2066 - 2070	2,485
<u>Total</u>	<u>\$ 483,600</u>

The approximate cost of property subject to operating leases and property held for lease at June 30, 2005 consisted of:

	(in thousands)
Land and land improvements	\$ 52,473
Buildings, structures, and related improvements at cost, less accumulated depreciation of \$145,846	60,846
<u>Total</u>	<u>\$ 113,319</u>

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Notes to Financial Statements

Note 10 - Employee Benefit Plans:

a. Retirement Plans

City and County of San Francisco

Plan Description - The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Port along with other employees of the City. The Plan provides basic service retirement, disability and death benefits based on specified percentages of defined final average salary and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, California 94102 or by calling (415) 487-7020.

Funding Policy - Contributions are made to the basic plan by both the Port and its employees. Employee contributions are mandatory. Employee contribution rates for 2005 and 2004 varied from 7.0% to 8.0% as a percentage of covered payroll. The Port is required to contribute at an actuarially determined rate which was 4.48% for June 30, 2005 and 0% for the years ended June 30, 2004 and 2003. The Port's employer contributions amounted to \$702,000 for 2005. The Port's contributions to the Retirement System on behalf of its employees amounted to \$3,000, \$8,000 and \$908,000 for the years ended June 30, 2005, 2004 and 2003, respectively. Certain collective bargaining agreements effective in 2004 and 2003 mandated employee-paid contributions at various levels. In 2005 and 2004, substantially all required employee contributions were paid to the Retirement System by such affected employees. In 2003, certain groups of employees contributed 2.75% of covered payroll as employee-paid employee contributions and the Port's contributions to the Retirement System on behalf of such employees were reduced and varied from 4.25% to 5.25%. For those groups of employees not mandated to contribute to the Retirement System, the Port's contributions remained at 7.0% to 8.0% of covered payroll.

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State of California

Plan Description - The Port also contributes to the California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the state of California. Certain employees who commenced their employment at the Port prior to February 1969 are eligible to participate in PERS. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

Funding Policy - Participating employees are required to contribute 7 percent of their salary to PERS. The Port is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis recommended by PERS actuaries and actuarial consultants and adopted by the Board of Administration.

There were no contributions required in 2005, 2004 and 2003. The City's Comprehensive Annual Financial Report contains disclosures for all covered City employees. Amounts for the Port are not separable from the City totals in those disclosures.

b. Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code (IRC) Section 457. The Plan, available to all Port employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

In accordance with GASB Statement No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans", Plan assets and related liabilities to Plan participants are not included in the City's financial statements. The City has no fiduciary accountability for the Plan. It has no administrative involvement and does not perform the investing function.

The amounts deferred by Port employees totaled \$969,000, \$1,114,000 and \$1,038,000 for 2005, 2004 and 2003, respectively.

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Notes to Financial Statements

c. Health Care Benefits

Health care benefits of Port employees, retired employees and surviving spouses are financed by beneficiaries and by the City principally through the City and County of San Francisco Health Service System. The Port's contribution, which amounted to approximately \$836,000, \$820,000 and \$747,000 in fiscal years 2005, 2004 and 2003, respectively, is determined by Charter provision based on similar contributions made by the ten most populous counties in California. The cost of providing benefits for the Port's retirees is not separable from the cost of providing benefits for its active employees. The Port's liability for both current employee and post retirement health care benefits is limited to its annual contribution. The Port's contribution is paid out of current available resources and funded on a pay-as-you-go basis. The Health Service System issues a publicly available financial report that includes financial statements and supplementary information for the health care benefits. That report may be obtained by writing to the San Francisco Health Service System, 1145 Market Street, 2nd Floor, San Francisco, CA 94103 or by calling (415) 554-1700.

d. Wellness Incentive Program

Effective July 1, 2002, the City established, on a pilot basis, a Wellness Incentive Program (the Program) to promote workforce attendance. Under the Program, any full-time employee leaving employment of the City upon service or disability retirement may receive payment for a portion of accrued sick leave credits at the time of separation. The amount of this payment is based on two and one-half percent of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, are not included in this computation. The pilot program currently extends through June 30, 2006 and the estimated future payments under the Program are included in the accrued liabilities disclosed in Notes 6 and 7.

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Notes to Financial Statements

Note 11 - Related Party Transactions:

The Port receives services from, and provides services to, various City departments. The cost of services received, included as operating expenses in the financial statements, was approximately \$9,165,000 in 2005 and \$11,180,000 in 2004.

Services provided, included in operating revenue, amounted to approximately \$3,660,000 and \$3,770,000 in 2005 and 2004, respectively. Receivables relating to such transactions are disclosed in Note 3. Under a guaranteed payment agreement for parking fine revenues collected from Port property, the Port received \$1.2 million from the Department of Parking and Traffic in 2005 and 2004.

Note 12 - Commitments, Litigation and Contingencies:

a. Commitments

The Port is presently planning various development projects which involve a commitment to expend significant funds. Under an agreement with The San Francisco Bay Conservation and Development Commission finalized in 2001 (The San Francisco Waterfront Special Area Plan), the Port is committed to fund and expend up to \$30 million over a 20 year period for pier removal, parks and plazas and other public access improvements. As of June 30, 2005, \$16.5 million has been appropriated and \$1.6 million has been expended for projects under the agreement. The \$16.5 million in approved appropriations include \$9.0 million received from the sale of a portion of a seawall lot to a developer. In accordance with the development agreement and the entitlement legislation, these proceeds are restricted for the design and construction of a public plaza required by the Special Area Plan.

The Port had firm purchase and contract commitments at June 30, 2005 for approximately \$14,472,000 for capital projects and \$1,143,000 for general operations.

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Notes to Financial Statements

The Port has a noncancellable operating lease (sublease) for its offices at Pier 1 which requires the following minimum annual payments (in thousands):

2006	\$ 2,739
2007	2,936
2008	2,936
2009	2,936
2010	2,936
2011 - 2015	14,684
2016 - 2020	13,888
2021 - 2025	13,888
2026 - 2030	13,888
2031 - 2035	13,888
2036 - 2040	13,888
2041 - 2045	13,888
2046 - 2050	11,341
Total	\$ 123,836

The Port has an option to purchase the leasehold premises for a purchase price equal to the present value of all the remaining Base Rent due from the Port to the sublandlord through the expiration date of the sublease. Rental payments totaled \$2,576,000 in 2005 and \$2,563,000 in 2004.

b. Litigation

The Port is a defendant in various lawsuits and claims; most deal with personal injury or property damage resulting from accident or fire and are covered by insurance. In the opinion of counsel the likelihood of an unfavorable outcome is probable in some of the suits and, accordingly, accrued liabilities include the aggregate amount of deductibles under applicable insurance policies. However, a number of the lawsuits are in the discovery stages and counsel to the Port cannot express an opinion as to the possible outcome of such litigation. Port's management believes that the ultimate resolution of such matters is not expected to have a material effect on the Port's financial position or results of operations.

**Port Commission
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Notes to Financial Statements

c. Contingencies

Risk Management

The Port is subject to various risks of loss including general liability, property and casualty, workers' compensation and employee health and accident. The Port carries commercial insurance for all risks of loss except workers' compensation, property damage to Port-owned vehicles and employee health and accident. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. The administration of workers' compensation, including estimates of recorded and incurred but not reported claims, is provided by the City. The workers' compensation liability as of June 30, 2005 and 2004 has been evaluated by an independent actuary.

Changes in the reported liability reserves for 2005 and 2004 resulted from the following activity:

	General Liability		Workers' Compensation	
	2005	2004	2005	2004
	(in thousands)			
Beginning of the year	\$ 2,287	\$ 1,900	\$ 3,113	\$ 2,931
Current year claims and changes in estimate	300	2,265	417	1,122
Claim payments	(860)	(1,878)	(804)	(940)
End of year	\$ 1,727	\$ 2,287	\$ 2,726	\$ 3,113

The general liability and workers' compensation liability reserves are included in accrued liabilities in the financial statements.

Grants

Certain grants that the Port receives are subject to audit and final acceptance by the granting agency based upon their review of costs incurred. Port's management does not believe that such audits will have a material impact on the financial statements.

**Port Commission
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Notes to Financial Statements

Dry Dock #1

In November 2002, a maritime vessel known as Dry Dock #1 broke free from its moorings at Pier 70 and went adrift in very high winds, finally running aground on Yerba Buena Island. The Port is evaluating options for the final disposition of this surplus vessel.

Environmental

Port lands are subject to environmental risk elements typical of sites with a mix of light industrial activities dominated by transportation, transportation-related and warehousing activities. Due to the historical placement of fill of varying quality, and widespread use of aboveground and underground tanks and pipelines containing and transporting fuel, elevated levels of petroleum hydrocarbons and lead are commonly found on Port properties. Consequently, any significant construction, excavation or other activity that disturbs soil or fill material may encounter hazardous materials and/or generate hazardous waste.

The Port has identified certain environmental issues related to Port property, including asbestos removal, fuel tank removal and oil contamination. The Port may be required to perform certain clean-up work if it intends to develop or lease the property, or at such time as required by the city or state. The Port projects currently estimable testing and remediation costs to be in the range of \$0.5 million to \$0.9 million of which \$0.5 million is accrued as of June 30, 2005. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for such risk cannot be reasonably made at this time.

PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO

JUNE 30, 2006 AND 2005

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

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Dear Sir or Madam:

Enclosed for your information are the Financial Statements and Independent Auditor's Report for the Port of San Francisco for the fiscal years ended June 30, 2005 and 2006. I am pleased to report an increase in the Port's net assets of \$10.4 million for the fiscal year ended June 30, 2006.

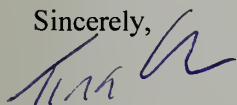
Revenue bond coverage on the Port Commission Revenue Refunding Bonds was 4.59x for fiscal year 2006 and 3.63x for fiscal year 2005; computed as follows:

(\$ in Thousands)	Fiscal Year Ended	
	June 30, 2005	June 30, 2006
Revenues		
Maritime ¹	\$11,865	\$11,138
Real Estate & Asset Management	43,699	45,375
Interest Income ²	1,603	2,951
Other Operating Revenue	<u>1,945</u>	<u>2,283</u>
Total Revenues	\$59,112	\$61,747
Operations & Maintenance Expense ³	(\$41,210)	(\$43,637)
Net Revenues	\$17,902	\$18,110
Debt Service	\$4,932	\$3,944
Debt Service Coverage Ratio	3.63x	4.59x

1. Excludes \$100 EPA grant to reimburse Port for rent credits given to cruise ships for their use of low sulfur fuel.
2. Interest income from funds on deposit with the City Treasury plus late charges from tenants.
3. Excludes amortized dredging costs.

If you have any questions about the financial statements, or the debt service coverage calculation, please contact Lawrence Brown at (415) 274-0446.

Sincerely,



Tina Olson
Director, Finance and Administration

encl:

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Independent Auditors' Report
and Financial Statements**

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Independent Auditors' Report

THE HONORABLE EDWARD HARRINGTON
CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

We have audited the accompanying balance sheet of the **PORT COMMISSION, CITY AND COUNTY OF SAN FRANCISCO, PORT OF SAN FRANCISCO (the Port)**, an enterprise fund of the City and County of San Francisco, as of June 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Port as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 - 11 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Hood & Strong LLP

September 29, 2006

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**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Overview of the Financial Statements

This discussion and analysis is a narrative overview and analysis of the financial activities of the Port of San Francisco (Port). It serves as an introduction to the audited financial statements, which can be found on pages 12 - 40 of this report. This overview should be read in conjunction with the more detailed information contained within the accompanying financial statements.

The Port is a self-supporting enterprise department of the City and County of San Francisco (City) and its financial statements are included in the City's Comprehensive Annual Financial Report. Only the accounts of the Port are included in the financial statements that follow. The Port Commission is responsible for seven and one-half miles of waterfront property, which was transferred in trust from the State of California to the City in 1969. The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations, which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Additional information concerning the Port's organization and the basis of presentation for this financial report is contained in Note 1 to the financial statements (pages 16 - 17).

The Balance Sheet presents information on all of the Port's assets and liabilities, with the difference between the two reported as "net assets." Increases and decreases in net assets serve as a useful indicator of the financial position of business enterprise entities like the Port. Comparative information of the Port's financial position is presented as of June 30, 2006 and 2005.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Port's net assets changed during the most recent two fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. uncollected rents from tenants and earned, but unused vacation leave).

The Statement of Cash Flows presents information about the cash receipts and cash payments of the Port during the most recent two fiscal years. This statement shows the effects on financial position of cash and non-cash operating, investing, capital, and financing transactions. When used with related disclosures and information in the other financial statements, the information in the Statement of Cash Flows helps readers assess the Port's ability to generate net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes follow the financial statements and can be found on pages 16 - 40 of this report.

Following is a presentation of certain condensed financial information derived from the basic financial statements.

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Management's Discussion and Analysis

Condensed Financial Information – Port of San Francisco

Comparative Net Assets (in thousands)

	June 30,			
	2006	2005	Change	% Change
Current and other assets	\$ 90,136	\$ 88,390	\$ 1,746	2.0
Capital assets	270,124	252,971	17,153	6.8
Total assets	360,260	341,361	18,899	5.5
Long-term debt obligations	19,270	22,554	(3,284)	(14.6)
Other liabilities	33,223	21,385	11,838	55.4
Total liabilities	52,493	43,939	8,554	19.5
Net assets:				
Invested in capital assets, net of related debt	256,466	236,256	20,210	8.6
Restricted	16,758	21,848	(5,090)	(23.3)
Unrestricted	34,543	39,318	(4,775)	(12.1)
Total net assets	\$ 307,767	\$ 297,422	\$ 10,345	3.5

Changes in Net Assets (in thousands)

	Year Ended June 30,			
	2006	2005	Change	% Change
Revenues:				
Program revenues:				
Rents and other operating revenues	\$ 58,588	\$ 57,519	\$ 1,069	1.9
Capital grants and other contributions	3,460	13,501	(10,041)	(74.4)
General revenues	3,311	1,698	1,613	95.0
Total revenues	65,359	72,718	(7,359)	(10.1)
Total expenses	55,329	54,941	388	0.7
Change in net assets before Special Items	10,030	17,777	(7,747)	(43.6)
Special Items	315	3,685	(3,370)	(91.5)
Increase in net assets	10,345	21,462	(11,117)	(51.8)
Net assets, beginning of the year	297,422	275,960	21,462	7.8
Net assets, end of the year	\$ 307,767	\$ 297,422	\$ 10,345	3.5

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Financial Analysis

Assets exceeded liabilities by \$307,767,000 at the close of the most recent fiscal year. Total net assets as of June 30, 2006 increased \$10,345,000 from June 30, 2005. This increase follows a \$21,462,000 increase posted for the previous fiscal year. The 2006 results reflect an increase in Operating Income, together with a significant decrease in non-operating revenues (i.e. grants and other capital contributions). While there has been some increase in property rental revenues, the overall net increase remains largely attributable to nonrecurring revenue transactions and expense variances. The more significant variances and nonrecurring transactions are discussed below in more detail.

The largest portion of the Port's net assets, 83 percent at June 30, 2006 and 79 percent at June 30, 2005, reflects its investment in capital assets (e.g. land, buildings and equipment). The Port is responsible for a seven and one-half mile stretch of waterfront land and its revenue is derived primarily from property rentals to commercial and industrial enterprises and a diverse mix of maritime operations. As disclosed in Note 1 to the financial statements, land transferred from the State of California to the City is reported at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State to reflect appraised values in 1929. The total amount of net assets tied to capital assets (\$256,466,000 at June 30, 2006) represents assets that are not available for future spending. Although the investment in capital assets is reported net of related debt, the resources needed to repay the debt must be provided from other sources (i.e. other Port assets or operating revenues). The capital assets themselves cannot be used to liquidate those liabilities. The remaining portion of net assets at June 30, 2006 consists of \$16,758,000 restricted by current agreements for specified capital expenditures and \$34,543,000 that is unrestricted and available to meet the Port's ongoing obligations and future capital investments.

The Statement of Revenues, Expenses and Changes in Net Assets on page 13 presents the Port's operating revenues in more detail by industry revenue types. Operating revenues for the year ended June 30, 2006 increased \$1,069,000 or 1.9%. As set forth in Note 9 to the financial statements (page 31), overall property rentals across all revenue types posted a net increase of \$2,593,000 in 2006: \$1,967,000 from minimum or base rentals and \$626,000 from percentage rents over minimum base rents ("overage rents"). Overage rents are being sustained at a level above that of fiscal 2001 (\$8,542,000) – before the terrorist events of September 11, 2001 and a contemporaneous economic downturn. Parking-related revenues, which include lots leased to parking operators, parking stalls, meters on Port streets and fine revenues collected by the City on Port property, represent the second largest revenue type at the Port. Parking revenues have grown steadily for the last several years.

The net decrease in 2006 cargo revenues versus 2005 reflects the full-year effect in 2006 of a new operating agreement that became effective January 2005. The new agreement splits terminal revenues between the Port and the terminal operator. Cruise and ship repair activity were strong in 2006 and 2005. There were more cruise calls in 2006, as well as higher passenger counts. The passenger wharfage rate also increased 5% effective January 2006.

Other Operating Revenues include permit fees and various one-time fees realized from major development projects and certain leases on Port property. Such fees were higher in 2005 than in 2006.

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Capital grants and other contributions consist principally of funds received or receivable from federal, state and local grant agencies which provide funding for several of the Port's capital projects. This revenue source fluctuates widely, based on grant funds availability and the capital work in progress at the Port. Significant work was in progress during 2005 on security enhancement projects funded by the Transportation Security Administration, Department of Homeland Security (\$3.3 million). Other capital contributions recorded in 2005 include \$4.3 million from a developer and the \$5.0 million value of a surplus dry dock donated to the Port under a conditional transfer arrangement executed in August 1999. Except for \$2.0 million of local transportation funds expended on the Illinois Street Bridget project, grant-funded project expenditures in 2006 were much lower than that of 2005.

All revenues not reported in the foregoing condensed summaries as Program Revenues, as defined in Government Accounting Standards Board Statement No. 34, are presented as General Revenues. General Revenues for 2006 and 2005 included interest and investment income (\$2,993,000 and \$1,698,000, respectively). In 2006, the Port also received \$307,000 in forfeitures from a contractor and \$11,000 from the disposition of equipment.

Total expenses of \$55,329,000 for 2006 represent a \$388,000 increase from 2005. Comparatively, total expenses for 2005 of \$54,941,000 represent a \$6,952,000 decrease from 2004. One-time charges accounted for many of the larger expense variances in recent years. Some regular operating budget items like workers compensation and insurance continue to fluctuate, but normalization is expected in future periods. The more significant cost and expense changes in 2006 included the following (in thousands):

	<u>Increase / (Decrease)</u>
Salary and fringe benefit costs	\$ 1,416
City expense allocations and service recoveries	1,973
Workers' compensation	702
General liability costs	217
Operating subsidy to Pier 80 terminal operator	(1,435)
Dredging expense	(1,141)
Provision for bad debts expense	(815)
Depreciation and amortization	(431)
Interest savings due to refunded bonds	(244)

Salary and fringe benefit cost increases were driven partially by the filling of several positions and increased use of interns and temporary hires (\$563,000). Mandatory fringe benefit costs continue to increase, especially with a higher required employer contribution to the city retirement plan (\$340,000). The charge for retiree health benefits allocated to the Port in 2006 increased by \$250,000, largely due to a change in the City's allocation methodology. Beginning with 2006, retiree health costs are allocated to departments in proportion to the department's active full-time equivalent headcount to total active employees of the City. Previously, such retiree costs were charged to the department from which an employee retired. Since 2004, substantially all mandated employee contributions were paid to the retirement system by affected employees (i.e. no "retirement pick-up" expense).

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City expense allocations and certain reimbursements to other city departments for services increased by \$1,973,000 in 2006. The countywide overhead allocation in 2006 increased \$1,274,000 (the 2005 allocation was a credit adjustment of \$261,000). Direct service charge increases from the Fire Department and City Attorney accounted for \$419,000 of the 2006 expense variance.

In 2004, the Port Commission adopted the findings of a nexus study that analyzed the balance of payments between the Port and City. That study established a record of certain past expenditures and provided a systematic means for determining the balance of payments for future periods. The final 2006 nexus allocation for General Fund services was \$280,000 higher than 2005. The Port and City are in continuing discussions concerning the methodologies used for the allocation of certain City costs and expenses.

A new management agreement between the Port and its terminal operator at Pier 80 became effective January 2005, shifting the focus of terminal operations from container to break bulk cargoes and ending a previous guaranteed compensation arrangement. Break bulk or neo bulk cargo is general, non-containerized cargo, such as steel, lumber and newsprint. This focus on break bulk cargo allows the Port and the terminal operator to significantly reduce staffing, security and utility costs. Under the new operating agreement, terminal revenues are shared between the Port and the terminal operator.

Special Items identify significant transactions or events within the control of management that are either unusual in nature or infrequent in occurrence. In 2001, the Port entered into an agreement giving the San Francisco Municipal Transportation Agency (MUNI) the permanent right to use certain land for its Metro East Maintenance and Operations Facility. MUNI paid a total use fee of \$29,700,000 for these property rights. A portion of the fee (\$4,000,000) was restricted for the construction of a new rail bridge. Construction on the bridge commenced in 2005. Consequently, deferred revenue of \$315,000 and \$3,685,000 was recognized as of June 30, 2006 and 2005, respectively.

Capital Asset and Debt Administration

Capital assets. The Port's investment in capital assets as of June 30, 2006 amounts to \$270.1 million, net of accumulated depreciation. This investment in capital assets includes land, certain street and road improvements, pier promenades, pier substructure, buildings and related improvements, vehicles, equipment and furniture. As of June 30, 2006, capital assets, net of depreciation and amortization, increased about seven percent from 2005. Additional information on the Port's capital assets can be found in Note 4 on pages 24 - 25 of this report.

Major capital asset events of fiscal 2006 and 2005 included the following:

- *Completion of the Ferry Terminal Public Pier.* This \$2.0 million project connected a freestanding breakwater at the Downtown Ferry Terminal with the Embarcadero Promenade and added public pedestrian improvements to the top of breakwater. Pedestrians can now walk out over the Bay; fish; view interpretative signage about ferry activities, Bay currents and habitat; observe ferry operations in the adjacent harbor; and enjoy views of the City and the Bay Bridge.

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- *Completion of federally-funded port security projects.* The Transportation Security Administration provided funding for three projects to enhance facility and operational security at the Port's cruise, ferry and cargo facilities. Including costs funded locally, the Port expended \$4.3 million for the Pier 35 cruise passenger terminal. Another \$0.9 million was expended for gate and access control projects at the Downtown Ferry Terminal and the Pier 80 cargo terminal.
 - *Completion of Pier 52 Parking Lot Improvements.* This \$0.5 million project provides for a parking lot with 40 spaces capable of handling vehicles with trailers and a small timber structure to house an oil recycling shed.
 - *Completion of Amador Street Extension.* This \$0.5 million project provides a temporary paved access road to link Piers 90-92 and Piers 94-96. The roadway will relieve vehicle congestion at Cargo Way and Third Street, and improve vehicle access to Port tenants located at Pier 90-92.
 - *Substructure repairs at Piers 1 ½ - 5.* The developer-tenant completed significant substructure repairs and upgrades as part of certain initial improvements specified in the Lease Disposition and Development Agreement and is entitled to the maximum allowable rent credit of \$10,000,000, to be amortized against certain rents due under the lease commencing April 2006.
 - *Illinois Street Intermodal Bridge.* The estimated total project cost is currently \$26.9 million. Due to funding requirements, the bridge construction will be completed under two separate contracts. The first contract, which covers the design and construction of the bridge and the north approach, is scheduled for completion later this calendar year. The Port recently received funding agency approval to advertise the second contract for construction of the south approach. Construction under the first contract commenced in May 2005. The bridge is being constructed over Islais Creek and extends Illinois Street from the north side of the creek, adjacent to the Pier 80 cargo terminal, to Pier 90 on the south side of the creek. Completion of this project will provide replacement freight rail service to Pier 80 previously accessed via Potrero Way at 16th Street. The bridge will also provide for two-way truck/vehicular traffic across the bridge, opening of the bridge for watercraft in the creek, and bicycle and pedestrian access across the Bridge.
 - *Pier 48.* Since a 1996 fire, a total of \$14.7 million of construction work has been completed at Pier 48. Insurance-funded repair to fire-damaged facilities on the pier and certain seismic repairs to the pier were completed in June 2003. Certain Port-funded electrical service upgrades were completed in November 2003 and other maintenance repair work is pending. The pier will return to leasable property inventory after a required CEQA determination process.

At June 30, 2006, \$35.6 million remain appropriated for capital project related expenditures, including pier repair and major maintenance projects. Port Engineering has been performing facility condition surveys to identify and prioritize immediately required maintenance projects that preserve and extend the economic life of the Port's productive assets.

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Management's Discussion and Analysis

The Port has entered into a number of public/private partnerships with developers for the historical preservation, renovation, and redevelopment of Port properties. Current information concerning major development projects and opportunities can be found at the Port's website: www.sfport.com. Some of the more significant activities and events of 2006 and 2005 include:

Piers 1½ - 5 – The project calls for rehabilitation of historic bulkhead buildings with ground floor restaurants, upper floor office, public access walkways and guest boat dock. Construction commenced in April 2004 and anticipated completion of shell construction in Fall 2006.

Rincon Park Restaurants – This project entails the construction of two new restaurants on the northeastern waterfront at the south end of Rincon Park along the Embarcadero Promenade. Construction commenced in August 2006.

Bryant Street Piers Mixed Use and Cruise Terminal Development – The original project transaction documents were approved by the Port Commission in March 2003 and by the Board of Supervisors in July 2003. The project was planned as a mixed use development with a two-berth cruise ship terminal, ground floor retail and restaurant, and upper floor office and entertainment uses on Piers 30-32. The Phase I residential condominium tower project, built on a portion of Seawall Lot 330 sold to the developer, was completed in April 2006 and sales of the 136 residential units are in progress. Concept design for the Phase 2 bayfront urban park on The Embarcadero between Piers 30-32 and Pier 38 ("Brannan Street Wharf") was also completed. The Lease Disposition and Development Agreement ("LDDA") between the Port and the developer expired in September 2006, without the developer exercising its option to extend the term of the LDDA. Significant project entitlements remain in place. The Executive Director is forming an advisory panel to provide recommendations by Spring 2007 to assist the Port Commission in its review and update of project goals and objectives.

In connection with the original Piers 30-32 mixed-use cruise terminal development project, and as approved by state legislation in 2001 (Assembly Bill No. 1389), a portion of Seawall Lot No. 330 was sold to a developer in 2004. The land was sold for \$9,324,000. Certain proceeds from the land sale (\$9,000,000) are specifically restricted for the construction of a public plaza area called Brannan Street Wharf. The remaining proceeds of \$324,000, together with certain residual receipts from the sale of residential condominium units built on the land sold, are restricted for the construction of the cruise terminal and the Brannan Street Wharf. Construction of the condominium project was completed and sale of the residential units began in April 2006. It is anticipated that all the units will be sold and the residual receipts that accrue to the Port will be received within the next fiscal year period ending June 30, 2007.

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Other development projects are in various stages of review and negotiation under exclusive rights (ERN) agreements. The Exploratorium, a museum of science, art and human perception, is considering leasing and rehabilitating portions of Piers 15-17. The Board of Supervisors passed a resolution in June 2005 exempting the potential lease from the competitive bidding process required by Administrative Code Section 2.6-1. The Port Commission approved an ERN with the Exploratorium in February 2006. A City-required fiscal feasibility report was heard before and approved by the Board of Supervisors in July 2006. The Port Commission approved assignment of the ERN for a mixed-use recreation project at Piers 27-31 to a new developer in March 2006. The original mixed-use recreation development on a 19-acre complex of historic piers contemplated a new Northeast Wharf Plaza, a new YMCA and Marine Sports Basin, indoor and outdoor recreation as well as offices, restaurants and recreation-oriented retail uses. Negotiation is underway for a revised development memorandum for review before the Port Commission and the Board of Supervisors.

Development and planning activities are also being directed at master planning for the Pier 70 Opportunity Area and preliminary feasibility analyses for environmental, engineering and economic viability of development in the Piers 90-94 Backlands.

In accordance with the City's Administrative Code Section 2.30, the Port developed its first, comprehensive ten-year capital plan in 2006. A database covering all Port facilities was created, quantifying outstanding capital needs, which consist primarily of repair and replacement work required due to deferred maintenance and code compliance work (i.e. required seismic retrofit). Port staff developed a per-unit cost methodology to estimate capital costs with similar facilities. Where more specific cost estimates were available, often from studies by private development partners or Port engineering reports, those estimates were adjusted for inflation and used in the detailed analysis. This review of the Port's capital assets resulted in the identification of 671 capital projects, totaling more than \$1.2 billion. Potential funding has only been identified for 34% of the total. Over \$800 million are in unfunded projects – projects for which the Port (1) does not expect to have sufficient funds to cover the estimated costs to repair and upgrade the facility, and (2) has not issued an RFP or entered into negotiations with a developer to finance the upgrades. Several funding options may exist to address this unmet need, such as development projects and grant opportunities. However, the Port has not secured any of those options. Each new funding option will require substantial staff time to develop and implement as well as support from policy makers and, in the case of potential development projects, the support of the California State Lands Commission and the San Francisco Bay Conservation and Development Commission.

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Senate Bill No. 1085, signed by the Governor in September 2005, amended the California Government Code to authorize public trust grantees to form infrastructure financing districts pursuant to Section 53395 et seq. The infrastructure district law allows public agencies to finance public infrastructure improvements by capturing and bonding against tax increment generated in the district after it is established. This legislative amendment incorporates changes that enable the City and Port to apply this law to the Port area. Among other things, it authorizes the use of such districts for urban waterfront areas in addition to undeveloped or underdeveloped areas; specifically clarifies that publicly-owned property subject to tidelands trust for commerce, navigation and fisheries (the "public trust"), including filled tidelands, may be included in such districts; and enumerates additional examples of infrastructure improvements that qualify for infrastructure financing districts, including seismic upgrades, historic renovation, environmental remediation, utility improvements, structural repair or construction of seawalls, piers and wharves. A multi-step process must be followed to establish an infrastructure financing district. These steps include defining the boundaries of a district, developing the infrastructure plan and obtaining approval from the Board of Supervisors.

Long-term obligations. Detailed information concerning the Port's long-term obligations can be found in Note 8 on pages 28 - 31 of this report. As of June 30, 2006, the Port had total long-term obligations of \$19,270,000 including \$4,059,000 that will mature during the next fiscal year. Long-term obligations consist of \$15,991,000 in revenue bonds and \$3,279,000 in loans that are secured by specified revenue sources. As discussed in Note 8, the Port issued new refunding revenue bonds in August 2004 to current refund the outstanding Series 1994 Revenue Bonds. The term of the bonds was not extended. The current refunding was completed to take advantage of lower interest rates, reducing total debt service over the next five years. No other debt was issued during the years ended June 30, 2006 and 2005.

Economic and Other Factors

Economy. In recent years general uncertainties concerning the national and local economic condition, as well as the focus on security since the acts of terrorism on September 11, 2001, impacted tourist travel and tourist-dependent sales venues in the City. After an extended period of reduced patronage, the Port's restaurant and retail tenants, in the aggregate, have reported progressively stronger sales activity. While the Port's operating results for the last two fiscal years reflect a solid recovery, the economic climate is uncertain. Economic challenges continue to arise: unstable fuel costs, inflationary pressures, and construction materials supply chain disruptions due to recent weather-related disasters. General economic conditions are taken into consideration when preparing budgets and forecasts.

The Port currently expects, in the aggregate, to be able to maintain revenues at current levels with modest year-to-year growth. As is standard with retail leases, a minimum fixed rent is paid to the Port at the beginning of every month. The Port has been able to maintain a fixed rent roll at approximately \$3.4 million per month and most of the Port's property rentals are covered by term leases. Note 9 (page 32) contains required financial statement disclosure information covering the future rental income stream from minimum rents over the noncancellable term of active operating leases. Revenue loss to the Port during down periods has been generally limited to some decline in overage rents (percentage rents above the minimum) and increased delinquencies.

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San Francisco Waterfront Special Area Plan. In July 2000, the Port agreed to amend its Waterfront Land Use Plan, and the San Francisco Bay Conservation and Development Commission (BCDC) its San Francisco Bay Plan to create consistent plans for the waterfront area between the Hyde Street Pier and China Basin (San Francisco Waterfront Special Area Plan). Among other things, the Special Area Plan commits the Port to expend up to \$30 million over a 20-year period for the removal of certain piers and the construction of major public plazas and other public access improvements. The Port is aggressively seeking other funding sources (i.e. grants and contributions) to finance the required pier removals and public access improvements. Until sufficient funding from other sources is secured, the Port must commit significant capital funds for the Special Area Plan projects. As of June 30, 2006, \$16.7 million has been appropriated and \$1.6 million has been expended for projects under the agreement.

Assembly Bill No. 1389, signed by the Governor of California in October 2001 to authorize approval of the development plans for a cruise ship terminal at Piers 30-32, also ratifies the San Francisco Waterfront Special Area Plan adopted by the Port and BCDC. Among other things, the legislation also established potentially accelerated timing for the construction of required one public plaza area in the Special Area Plan (the Brannan Street Wharf), in concert with BCDC permitting for construction of the cruise terminal.

Port security. The Port participates in a regional Port Security Committee, which reviews security issues and needs affecting ports and terminals in the San Francisco Bay Area. In June 2005, the Port hired a full-time homeland security manager – consolidating security and emergency preparedness functions variously covered by other employees. This position is responsible for developing, directing, overseeing and implementing a comprehensive security program mandated by the federal government.

Under the Port Security Grants Program, managed by the Transportation Security Administration (Department of Homeland Security), the Port of San Francisco received a first round grant to conduct a comprehensive security assessment study of its waterfront facilities. Subsequently, the Port was awarded a total of \$3.9 million in second and third round funding for certain capital improvements that improve facility and operational security at the Port's cruise, ferry and cargo facilities. As a department of the City, the Port has also been allocated funds from other Department of Homeland Security programs to plan for and to implement effective response to emergent threats to Port and City property.

Requests for Information

This report is designed to provide a general overview of the Port of San Francisco's finances. The financial statements and related informative disclosures in the notes to the financial statements and required supplementary information is presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Public Information Officer or the Fiscal Officer at Port of San Francisco, Pier 1, San Francisco, California, 94111.

Questions concerning the City and County of San Francisco or requests for a copy of the City's Comprehensive Annual Report should be addressed to: Office of the Controller, City and County of San Francisco, at City Hall, Room 316, 1 Dr. Carlton B. Goodlett Place, San Francisco, California 94102.

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**Balance Sheet
(in thousands)**

<i>June 30,</i>	2006	2005
Assets		
Current Assets:		
Cash and investments, held in City Treasury - Port operating fund	\$ 66,073	\$ 66,096
Cash outside of City Treasury	5	5
Receivables - net	5,369	5,410
Materials and supplies	1,152	1,174
Prepaid insurance and other assets	38	581
Total current assets	72,637	73,266
Restricted Assets:		
Cash held in City Treasury:		
Lessee deposits	4,081	3,752
Capital outlay	447	592
Bond interest and redemption held by trustee	6,420	6,294
Other - Lessee deposits	732	767
Total restricted assets	11,680	11,405
Capital Assets - net	270,124	252,971
Other Assets	5,819	3,719
Total assets	\$ 360,260	\$ 341,361
Liabilities		
Current Liabilities Payable from Current Assets:		
Accounts payable and accrued liabilities	\$ 11,432	\$ 9,756
Current maturities of long-term obligations	84	80
Accrued interest payable	135	139
Total current liabilities	11,651	9,975
Current Liabilities Payable from Restricted Assets:		
Current maturities of revenue bonds	3,975	3,390
Accrued bond interest payable	251	302
Lessee deposits	4,813	4,519
Deferred grants	7	154
Total payable from restricted assets	9,046	8,365
Noncurrent Liabilities	3,886	3,719
Deferred Revenue - Net of current portion	12,699	2,796
Long-term Obligations - Net of current maturities	15,211	19,084
Total liabilities	52,493	43,939
Net Assets:		
Invested in capital assets, net of related debt	256,466	236,256
Restricted	16,758	21,848
Unrestricted	34,543	39,318
Total net assets	307,767	297,422
Total liabilities and net assets	\$ 360,260	\$ 341,361

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**Statement of Revenues, Expenses and Changes in Net Assets
(in thousands)**

<i>Years Ended June 30,</i>	2006	2005
Operating Revenues:		
Commercial and industrial	\$ 35,803	\$ 34,791
Parking	9,122	8,600
Cargo	4,181	5,277
Fishing	1,609	1,520
Ship repair	1,105	1,021
Harbor services	1,003	997
Cruise	2,065	1,679
Other maritime	1,272	1,206
Other	2,428	2,428
Total operating revenues	58,588	57,519
Operating Expenses:		
Operations and maintenance	44,893	43,786
Depreciation and amortization	9,536	9,967
Total operating expenses	54,429	53,753
Operating income	4,159	3,766
Other Income (Expense):		
Interest and investment income	2,993	1,698
Interest expense	(900)	(1,144)
Other	307	
Gain (loss) from disposition of assets	11	(44)
Total nonoperating revenues and expenses	2,411	510
Capital Contributions - Capital grants and other contributions	3,460	13,501
Special Item - Use fee for property rights in perpetuity	315	3,685
Change in Net Assets	10,345	21,462
Net Assets - beginning of the year	297,422	275,960
Net Assets - end of the year	\$ 307,767	\$ 297,422

**Port Commission
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**Statement of Cash Flows
(in thousands)**

<i>Years Ended June 30,</i>	2006	2005
Cash Flows from Operating Activities:		
Cash received from tenants for rent	\$ 49,519	\$ 46,760
Cash received from customers and others	7,915	8,818
Deposits received from tenants and customers	638	572
Cash paid to employees for services	(20,903)	(19,575)
Cash paid to suppliers for goods and services	(9,646)	(12,529)
Cash paid for quasi-external transactions	(10,269)	(9,615)
Customer deposits returned	(276)	(326)
Net cash provided by operating activities	16,978	14,105
Cash Flows from Noncapital Financing Activities -		
Forfeiture income	307	
Net cash provided by investing activities	307	
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment	(16,160)	(10,554)
Dredging	(3,623)	(1,020)
Proceeds from Revenue Refunding Bonds, Series 2004		20,311
Payments of long-term debt, including defeasance of 1994 bonds in 2005	(3,470)	(28,058)
Interest payments on long-term debt	(705)	(1,386)
Bond issue costs		(308)
Capital grants received	3,809	2,404
Contributed capital other than grants		4,650
Proceeds from sale of equipment and materials	11	113
Pier demolition and other asset disposition costs		(34)
Proceeds from sale of land	324	
Net cash used by capital and related financing activities	(19,814)	(13,882)
Cash Flows from Investing Activities:		
Interest income received	2,984	1,586
Investments purchased by Trustee		(2,018)
Net cash provided (used) by investing activities	2,984	(432)
Net Increase (Decrease) in Cash and Cash Equivalents	455	(209)
Cash and Cash Equivalents - Beginning of year	74,722	74,931
Cash and Cash Equivalents - End of year	\$ 75,177	\$ 74,722

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**Statement of Cash Flows (In Thousands)
(Continued)**

<i>Years Ended June 30,</i>	2006	2005
Noncash Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment included in accounts payable and accrued liabilities	\$ 1,895	\$ 2,313
Tenant improvements financed by rent credit	10,947	
Surplus dry dock donated to Port		5,000
Loss on abandonment of property and equipment		11
Noncash Investing Activities:		
Change in fair value of cash and investments held in City Treasury	\$ (81)	\$ (22)
Change in fair value of U.S. Treasury Note held by bond trustee	(87)	(32)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income (loss)	\$ 4,159	\$ 3,766
Adjustment to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation and amortization	9,536	9,967
Change in allowance for doubtful accounts	156	918
Net change in deferred revenue	345	(366)
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables	(1,212)	(201)
Materials and supplies	22	96
Prepaid insurance and other assets	1,679	2,935
Increase (decrease) in:		
Accounts payable and accrued liabilities	1,964	(3,256)
Lessee deposits	329	246
Net cash provided by operating activities	\$ 16,978	\$ 14,105
Reconciliation of Cash and Cash Equivalents to the Balance Sheet:		
Cash and investments held in City Treasury - Port operating fund	\$ 66,073	\$ 66,096
Cash deposit outside of City Treasury	5	5
Cash held in City Treasury:		
Lessee deposits	4,081	3,752
Capital outlay	447	592
Cash held by Trustee - Bond interest and redemption (see Note 2)	4,515	4,308
	75,121	74,753
Fair value adjustment, cash and investments held in City Treasury	56	(31)
Cash and Cash Equivalents	\$ 75,177	\$ 74,722

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Notes to Financial Statements

Note 1 - Significant Accounting Policies:

a. Basis of Presentation

The Port of San Francisco (Port) is an enterprise fund of the City and County of San Francisco (City). Only the accounts of the Port are included in these financial statements. There are no component units that should be considered for inclusion in the Port's financial reporting entity.

A five-member Port Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for fixed terms of four years. The Port is an integral part of the City, and the accompanying financial statements are included in the City's Comprehensive Annual Financial Report.

Prior to February 1969, the Port was owned by the State of California ("State") and administered by the San Francisco Port Authority, a State agency. In February 1969, the State transferred the Port in trust to the City under the terms and conditions specified in the State statutes of 1968, Chapter 1333 ("Burton Act"), as amended, and ratified by the City's voters in November 1968.

Under the terms of the Burton Act, the State Legislature reserved the right to amend, modify, or revoke, in whole or in part, the transfer of lands in trust, provided that the State would then assume all lawful obligations related to such lands.

The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Substantially all of the Port's property rental customers are located within the boundaries of the City. Port revenues are held in a separate fund ("Harbor Fund") and are appropriated for expenditure pursuant to the budget and fiscal provisions of the City Charter, consistent with trust requirements. Under public trust doctrine, the Burton Act, and the transfer agreement between the City and the State, these revenues may be spent only for uses and purposes of the public trust.

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Notes to Financial Statements

The Port's financial statements are prepared using the economic resources measurement focus and the accrual basis in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the Port applies all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred.

In accordance with GASB Statement No. 34 (GASB 34) "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," the balance sheet presents the difference between assets and liabilities as net assets. Net assets are reported in three broad components, as applicable – invested in capital assets, net of related debt; restricted; and unrestricted. Under the all-inclusive approach to presenting the changes in net assets, all Port revenues, including capital contributions, are reported in the statement of revenues, expenses and changes in net assets.

b. Cash and Investments

The Port reports its investments at fair value based upon quoted market prices. Fair value is defined as the amount that the Port could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short term investments are reported at cost (or amortized cost), which approximates fair value. For purposes of the statement of cash flows, all unrestricted and restricted cash and highly liquid investments with maturities of three months or less, when purchased, are considered to be cash equivalents. In addition, the Port considers its deposits with the City Treasurer (see Note 2) to be demand deposits and therefore cash for the purposes of the statement of cash flows.

c. Materials and Supplies

Materials and supplies are used for construction and maintenance of Port facilities and are stated at average cost.

d. Restricted Assets

Cash security deposits received by the Port pursuant to lease agreements are held in the City Treasury. Other lessee deposits are renewable certificates of deposit tendered by tenants in lieu of cash and held by banks as third-party certificates in the name of the Port. Other lessee deposits also include deposits receivable pursuant to adjustment provisions in the leases.

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Notes to Financial Statements

Bond interest and redemption represent funds accumulated for debt service payments due in the next twelve months and reserve funds set aside to make up potential future deficiencies. A bond trustee holds these funds.

Capital outlay funds are restricted for use in construction and acquisition of equipment, due to restrictions from federal and state grant agreements and bond resolutions.

e. Capital Assets

Land transferred to the City in February 1969 is stated at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State in prior years to reflect appraised values in 1929.

Other capital assets are carried at cost or at fair market value at the date received in the case of property received by donation or by termination of a lease. Donated surplus equipment received from the federal government is carried at an estimated value determined in accordance with federal guidelines. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets. Land improvements (principally pavement and pier promenades) with a cost of approximately \$20 million are not depreciated because, in the opinion of management, the assets will be maintained to provide indefinite useful lives. Building (tenant) improvements are amortized using the straight-line method over the shorter of the estimated life of the asset or the remaining term of the related lease. Maintenance and repairs are expensed as incurred.

Interest paid on bond funds used for construction purposes, less interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, if applicable, is capitalized from the date of borrowing through the construction period.

f. Other Assets

Bond issue costs are amortized using the straight-line method over the life of the bond. Original bond issue premiums are offset against the related debt and amortized using the straight-line method over the life of the bonds.

Dredging costs are amortized using the straight-line method over the estimated useful period ranging from one to seven years.

Waterfront Land Use Plan (Plan) costs are amortized using the straight-line method over an estimated life of 20 years. The Plan was approved by the City Board of Supervisors in September 1997.

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Notes to Financial Statements

g. Deferred Revenue

Deferred revenue consists primarily of rent credits issued to customers. Deferred revenue is recognized in accordance with the lease agreements and is amortized using the straight-line method over the term of the specific leases.

h. Refunding Debt

The Port's 1994 revenue refunding bonds were current refunded in August 2004 (see Note 8). The difference between the reacquisition price and the net carrying amount of the old debt is deferred and together with the unamortized difference from the 1994 refunding is reported as a reduction of the bonds payable. The total deferred amount is being amortized on a straight-line basis over the remaining life of the bonds through 2010.

i. Operating Revenues and Expenses

The Port distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from the real estate, maritime and other principal ongoing activities of the Port's normal business operations. Real estate revenues consist principally of rentals of Port property to industrial, commercial, retail, office and other business enterprises. Maritime revenues are derived from vessel operations, warehousing, ship repair, harbor services and other maritime activities. Vessel operations include dry, liquid bulk, and break bulk cargoes, cruise, and other berthing. Other operating revenues include building permit and inspections fees. Operating expenses include facility maintenance, the cost of operations, administrative expenses and depreciation and amortization on capital assets. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Minimum base rental revenue is normally recognized on the straight-line basis over related lease terms. Most term leases provide that rents be payable to the Port in equal monthly installments on the first day of each month until terminated. Contingent rentals are recorded or accrued only for periods in which the contingent thresholds for gross sales or revenues are met. Use fees are recorded when the Port fee is determined based on actual occupancy or use. Fees are assessed by a measured unit (e.g. lineal feet of vessel for dockage) and/or measured time (e.g. per twenty-four hour day). Maritime activity or use fees may be based on a standardized tariff schedule or covered by specific contractual agreements.

Grants and similar revenue items are recognized as revenue as soon as all eligibility requirements have been met.

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Notes to Financial Statements

j. Capital Contributions

The Port, at various times, receives federal and state grants and other funds from external sources for construction of waterfront facilities. The funds are reported as capital contributions on the Statement of Revenues, Expenses and Changes in Net Assets.

k. Environmental Expenses

The Port incurs costs associated with environmental clean-up which arise during the normal course of business. These costs are recorded as a liability when the Port is required to perform the clean-up. Environmental liabilities are accrued when it is probable that obligations have been incurred and the associated amounts can be reasonably estimated.

l. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2 - Cash and Investments:

The Port maintains its operating fund cash and investments and a portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The Comprehensive Annual Financial Report of the City provides more detailed information concerning deposit and investment risks associated with the City's pool of cash and investments at June 30, 2006.

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Notes to Financial Statements

The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer, subject to review by the Treasury Oversight Committee. The Treasury Oversight Committee, established under California Government Code Sections 27130 to 27137, is composed of various City officials and representatives of agencies with large cash balances. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The provisions of the City's investment policy also address interest rate risk, credit risk, custodial credit risk and concentration of credit risk and provides for additional restrictions related to investments. Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City Treasurer manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. Credit risk is that risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The City's pool is not registered with the SEC as an investment company and is not rated. Custodial credit risk for investments is that risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments; however, it is the practice of the City Treasurer that all investments are insured, registered or held by the Treasurer's custodial agent in the City's name. To address concentration of credit risk, the policy specifies authorized investment types and sets parameters for maximum maturity, maximum percentage of the total portfolio which may be invested in specific investment types, and maximum investment to one issuer for certain investment types. U.S. Treasury and Agency securities are not subject to this limitation.

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Notes to Financial Statements

Custodial credit risk for deposits is that risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging authorized securities as collateral. The fair value of pledged securities must equal at least 110 percent of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2006, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

The Port's cash and investments, reported at fair value, at June 30, 2006 and 2005 are as follows:

	2006	2005
	(in thousands)	
Cash and investments in City Treasury	\$ 66,073	\$ 66,096
Cash outside of City Treasury	5	5
Restricted assets:		
Cash and investments in City Treasury	4,528	4,344
Deposits and investments outside City Treasury:		
Cash and investments held by bond trustee	6,420	6,294
Lessee deposits	612	618
	<u>\$ 77,638</u>	<u>\$ 77,357</u>

Lessee security deposits are held on behalf of the Port by third party trustees and invested in renewable certificates of deposit. These deposits, made by tenants and customers directly to banks, are held outside of the City Treasury and are not collateralized as public agency deposits. One uncollateralized account for \$167,000 exceeds the federal insurance limit.

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Notes to Financial Statements

At June 30, 2006 and 2005, cash and investments held in reserve and for debt service payments by trustee consist of:

	2006	2005
	(in thousands)	
Reserve Fund:		
U.S. Treasury Money Market Fund	\$ 162	\$ 37
U.S. Treasury Note, due June 15, 2009	1,905	1,986
Debt Service Funds -		
U.S. Treasury Money Market Fund	4,353	4,271
	<u>\$ 6,420</u>	<u>\$ 6,294</u>

Investment of all funds and accounts held by the bond trustee are governed by the Bond Indenture rather than the general provisions of the California Government Code or the City's investment policy. Investments held by the bond trustee consist of a single U.S. Treasury note maturing in 2009 in the Reserve Fund and shares of a registered money market fund. Although other investment types are permitted by the Indenture, their use is not anticipated. The money market fund has a Standard & Poor's rating of AAAm.

Note 3 - Receivables:

At June 30, 2006 and 2005, receivables consisted of:

	2006	2005
	(in thousands)	
Trade accounts receivable	\$ 5,238	\$ 4,906
Less allowance for doubtful accounts	(1,858)	(1,702)
	3,380	3,204
Grants receivable	1,410	1,906
Accrued interest receivable	466	289
Other	113	11
	<u>\$ 5,369</u>	<u>\$ 5,410</u>

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Notes to Financial Statements

Note 4 - Capital Assets:

At June 30, 2006 and 2005, capital assets consisted of:

	2006 (in thousands)	2005	Estimated Useful Life (Years)
Land and land improvements	\$ 120,454	\$ 119,452	
Buildings, structures and related improvements	282,503	273,279	5 - 64
Furniture, machinery and equipment	14,359	13,477	2 - 20
<u>Total</u>	<u>417,316</u>	<u>406,208</u>	
<u>Less accumulated depreciation</u>	<u>(183,103)</u>	<u>(173,631)</u>	
	234,213	232,577	
<u>Construction work in progress</u>	<u>35,911</u>	<u>20,394</u>	
<u>Total</u>	<u>\$ 270,124</u>	<u>\$ 252,971</u>	

Total interest cost was \$651,000 and \$905,000 for fiscal years 2006 and 2005. Total interest earned was \$3,081,000 and \$1,720,000 for fiscal years 2006 and 2005. No interest cost and earnings were capitalized in 2006 and 2005.

The buildings, structures and improvements identified above include pier substructures, which have an estimated useful life greater than 50 years. Such long-lived assets total \$21,915,000 as of June 30, 2006 and 2005.

The cost of fully depreciated assets still in use was approximately \$87,323,000 at June 30, 2006, including \$81,772,000 in buildings, structures and improvements and \$5,551,000 in furniture, machinery and equipment.

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Notes to Financial Statements

The following is a summary of changes in capital assets for the year ended June 30, 2006 (in thousands):

	Balance June 30, 2005	Increases	Decreases	Balance June 30, 2006
Land and land improvements	\$ 119,452	\$ 1,002		\$ 120,454
Buildings, structures and related improvements	273,279	9,224		282,503
Furniture, machinery and equipment	13,477	946	\$ 64	14,359
Total	406,208	11,172	64	417,316
Construction work in progress	20,394	25,356	9,839	35,911
	<u>426,602</u>	<u>36,528</u>	<u>9,903</u>	<u>453,227</u>
Less accumulated depreciation for:				
Buildings, structures and related improvements	165,473	8,427		173,900
Furniture, machinery and equipment	8,158	1,109	64	9,203
Total accumulated depreciation	173,631	9,536	64	183,103
Total	\$ 252,971	\$ 26,992	\$ 9,839	\$ 270,124

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Notes to Financial Statements

Note 5 - Other Assets:

Other assets at June 30, 2006 and 2005, net of related amortization, consisted of:

	2006	2005
	(in thousands)	
Deferred debt	\$ 189	\$ 252
Dredging costs	3,521	986
Waterfront land use plan	1,855	2,020
Notes receivable	125	324
Other deferred costs	129	137
	<u>\$ 5,819</u>	<u>\$ 3,719</u>

The note receivable of \$324,000 at June 30, 2005 is the deferred portion of the \$9,324,000 total purchase price for land sold to a developer in 2004. The developer elected to extinguish the obligation in 2006 with proceeds from the sale of the first condominium units built on the land sold. Interest on the note accrued at the prime or reference rate of a bank plus two percent (8.25% at June 30, 2005).

The notes receivable at June 30, 2006 is the long-term portion of a five-year installment payment agreement with a City department. In connection with a former subtenant and operator of a municipal tow yard on Port property, the Port and the City department agreed to a five-year monthly payment plan for certain rents still due to the Port upon termination of the towing contract by the City. The Port Commission approved the installment payment plan for total outstanding rents of \$193,191 plus interest at 2% per annum.

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Notes to Financial Statements

Note 6 - Accounts Payable and Accrued Liabilities:

At June 30, 2006 and 2005, accounts payable and accrued liabilities consisted of:

	2006	2005
	(in thousands)	
Accounts payable	\$ 4,457	\$ 3,971
Current portion of deferred revenue	932	622
Accrued liabilities	4,173	3,487
Accrued payroll, compensated absences and related costs	1,870	1,676
	<u>\$ 11,432</u>	<u>\$ 9,756</u>

Note 7 - Noncurrent Liabilities:

At June 30, 2006 and 2005, noncurrent liabilities consisted of:

	2006	2005
	(in thousands)	
Compensated absences and related costs	\$ 808	\$ 770
Workers' compensation	2,564	2,179
Litigation, claims and judgments	514	770
	<u>\$ 3,886</u>	<u>\$ 3,719</u>

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Notes to Financial Statements

Note 8 - Long-Term Obligations:

Long-term obligations at June 30, 2006 and 2005 consisted of the following:

	Interest Rate (%)	Fiscal Year Last Series Matures	Balance 2006 2005 (in thousands)	
Revenue bonds	2.25 - 4.00	2010	\$ 15,991	\$ 19,195
Loan payable	4.50	2029	3,279	3,359
Total long-term obligations			19,270	22,554
Less current maturities			(4,059)	(3,470)
Net long-term obligations			\$ 15,211	\$ 19,084

The following is a summary of changes in long-term obligations for the years ended June 30, 2006 and 2005 (in thousands):

	Revenue Bonds	General Obligation Bonds	Loans	Capital Lease	Total
Balances as of June 30, 2004	\$ 26,523	\$ 400	\$ 3,436	\$ 23	\$ 30,382
Current maturities, retirements and other decreases, net	(7,328)	(400)	(77)	(23)	(7,828)
Balances as of June 30, 2005	19,195	-	3,359	-	22,554
Current maturities, retirements and other decreases, net	(3,204)		(80)		(3,284)
Balances as of June 30, 2006	\$ 15,991	\$ -	\$ 3,279	\$ -	\$ 19,270

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Notes to Financial Statements

The annual payments required for all outstanding long-term obligations are as follows (in thousands):

	Revenue Bonds		Other Long Term Obligations		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
<u>Year Ending June 30:</u>						
2007	\$ 3,975	\$ 453	\$ 84	\$ 148	\$ 4,059	\$ 601
2008	4,070	348	88	144	4,158	492
2009	4,185	222	92	140	4,277	362
2010	4,320	75	96	136	4,416	211
2011			100	131	100	131
2012 - 2016			574	585	574	585
2017 - 2021			715	443	715	443
2022 - 2026			892	267	892	267
2027 - 2029			638	58	638	58
Total	\$ 16,550	\$ 1,098	\$ 3,279	\$ 2,052	\$ 19,829	\$ 3,150

Bonds

Bond obligations at June 30, 2006 and 2005 consisted of the following:

	Interest Rate (%)	Fiscal Year Last Series Matures	Balance	
			2006 (in thousands)	2005
Revenue Bonds -				
Series 2004	2.25 - 4.00	2010	\$ 16,550	\$ 19,940
Less:				
Current maturities			(3,975)	(3,390)
Unamortized bond premium			227	303
Deferred amount on refunding			(786)	(1,048)
Net Bond Obligations			\$ 12,016	\$ 15,805

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In August 2004, the Port issued \$19,940,000 in Revenue Refunding Bonds, Series 2004 with an average interest rate of 3.16% to current refund \$23,175,000 of outstanding Series 1994 Revenue Bonds with an average coupon rate of 5.84%. Net proceeds from the new bonds plus an additional \$3.9 million of Series 1994 debt service monies were used to defease the 1994 bonds. The Port completed the current refunding to reduce its total debt service payments over the next five years by \$1.6 million and to obtain an economic gain (difference between the present value of the old and new debt service payments) of \$1.2 million. The 1994 bonds refunded \$49,975,000 of outstanding 1984 Revenue Bonds, Series A, B and C with an average interest rate of 8.4 percent.

The refunding resulted in a difference between the reacquisition price (principal of the old debt plus 2% call premium) and the net carrying amount of the old debt of \$0.5 million. The previous 1994 refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$2.36 million. The total difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the fiscal year 2010 using the straight line method.

The revenue bonds are secured by a pledge of Net Revenues of the Port, as defined by the Revenue Bond Indenture. Under the terms of the Indenture, as amended, the Port is required to deposit with a trustee in a reserve fund, an amount equal to the lesser of (a) maximum debt service accruing in any year during the life of such bonds, (b) ten percent (10%) of the proceeds derived from the sale of Series 2004 Bonds, or (c) 1.25 times the average annual debt service due with respect to Series 2004 Bonds. At June 30, 2006, the Port was in compliance with this bond indenture requirement.

While Series 2004 Bonds are outstanding, the Port may not create liens on its property essential to operations, dispose of any property essential to maintaining revenues or operating the Port, and must maintain specified insurance. The Port may issue additional bonds under the Indenture provided the Port complies with the Additional Bonds Test, as defined in the indenture.

Covenants of the Indenture, as amended, include that the Port will maintain its business operations, and establish, and maintain rentals, rates, fees, and charges for the use of Port property and for services rendered by the Port so that the Net Revenue, as defined in the bond indenture, in each fiscal year will be at least equal to 130% of aggregate annual debt service for such fiscal year. At June 30, 2006, the Port was in compliance with such bond covenants.

The Series 2004 Revenue Bonds are subject to an arbitrage rebate requirement. The requirements stipulate, in general, that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The cumulative arbitrage liability as of June 30, 2006 was approximately \$62,000.

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Loans

The Port has entered into a loan agreement with the California Department of Boating and Waterways (Cal Boating) for \$3.5 million to finance certain Hyde Street Harbor improvements. The loan is subordinate to all bonds payable by the Port. Interest accrues at a rate of 4.5% per annum on the unpaid balance commencing with the first draw on the loan. The term is 30 years from the date of the first draw, which occurred in April 1998. The loan is secured by Gross Revenues as defined in the loan agreement. The project was completed as scheduled in 2002 and annual payments commenced on August 1, 2002.

	2006	2005
	(in thousands)	
Loan payable to Cal Boating	\$ 3,279	\$ 3,359
Less current portion	(84)	(80)
<u>Net loan payable</u>	<u>\$ 3,195</u>	<u>\$ 3,279</u>

Note 9 - Operating Revenues - Property Rentals:

Certain property rental agreements specify rental payments based on a percentage of tenant sales, subject to a minimum amount. Property rental revenues were comprised as follows:

	2006	2005
	(in thousands)	
Minimum rentals	\$ 40,819	\$ 38,852
Percentage rentals	9,826	9,200
	<u>\$ 50,645</u>	<u>\$ 48,052</u>

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Notes to Financial Statements

Minimum future rental income under noncancellable operating leases having terms in excess of one year are as follows:

<u>Year Ending June 30</u>	(in thousands)
2007	\$ 27,083
2008	25,088
2009	22,999
2010	20,244
2011	17,601
2012 - 2016	79,274
2017 - 2021	67,271
2022 - 2026	56,066
2027 - 2031	49,353
2032 - 2036	46,363
2037 - 2041	32,373
2042 - 2046	22,749
2047 - 2051	17,158
2052 - 2056	8,400
2057 - 2061	7,023
2062 - 2066	7,023
2067 - 2068	1,094
<u>Total</u>	<u>\$ 507,162</u>

The approximate cost of property subject to operating leases and property held for lease at June 30, 2006 consisted of:

	(in thousands)
Land and land improvements	\$ 52,473
Buildings, structures, and related improvements at cost, less accumulated depreciation of \$152,390	64,794
<u>Total</u>	<u>\$ 117,267</u>

**Port Commission
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Notes to Financial Statements

Note 10 - Employee Benefit Plans:

a. Retirement Plans

City and County of San Francisco

Plan Description - The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Port along with other employees of the City. The Plan provides basic service retirement, disability and death benefits based on specified percentages of defined final average salary and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, California 94102 or by calling (415) 487-7020.

Funding Policy - Contributions are made to the basic plan by both the Port and its employees. Employee contributions are mandatory. Employee contribution rates for 2006 and 2005 varied from 7.0% to 8.0% as a percentage of covered payroll. The Port is required to contribute at an actuarially determined rate which was 6.58% for June 30, 2006, 4.48% for the year ended June 30, 2005 and 0% for the year ended June 30, 2004. The Port's employer contributions amounted to \$1,056,000 and \$702,000 for 2006 and 2005, respectively. The Port's contributions to the Retirement System on behalf of its employees amounted to \$199,000, \$3,000, and \$8,000 for the years ended June 30, 2006, 2005 and 2004, respectively. In 2005 and 2004, substantially all required employee contributions were paid to the Retirement System by such affected employees. For those groups of employees not mandated by collective bargaining agreements to contribute to the Retirement System, the Port's contributions remained at 7.0% to 8.0% of covered payroll.

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Notes to Financial Statements

State of California

Plan Description - The Port also contributes to the California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the state of California. Certain employees who commenced their employment at the Port prior to February 1969 are eligible to participate in PERS. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

Funding Policy - Participating employees are required to contribute 7 percent of their salary to PERS. The Port is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis recommended by PERS actuaries and actuarial consultants and adopted by the Board of Administration.

There were no contributions required in 2006, 2005 or 2004. The City's Comprehensive Annual Financial Report contains disclosures for all covered City employees. Amounts for the Port are not separable from the City totals in those disclosures.

b. Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code (IRC) Section 457. The Plan, available to all Port employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

In accordance with GASB Statement No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans", Plan assets and related liabilities to Plan participants are not included in the City's financial statements. The City has no fiduciary accountability for the Plan. It has no administrative involvement and does not perform the investing function.

The amounts deferred by Port employees totaled \$1,166,000, \$969,000 and \$1,114,000 for 2006, 2005 and 2004, respectively.

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Notes to Financial Statements

c. Health Care Benefits

Health care benefits of Port employees, retired employees and surviving spouses are financed by beneficiaries and by the City principally through the City and County of San Francisco Health Service System. The annual contribution to the city health plan is determined by Charter provision based on similar contributions made by the ten most populous counties in California. The Health Service System issues a publicly available financial report that includes financial statements and supplementary information for the health care benefits. That report may be obtained by writing to the San Francisco Health Service System, 1145 Market Street, 2nd Floor, San Francisco, CA 94103 or by calling (415) 554-1700.

As noted above in Note 10a, certain employees who commenced their employment at the Port prior to February 1969 are eligible to participate in PERS. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

The Port's contribution, which amounted to approximately \$2,941,000, \$2,665,000 and \$2,526,000 in fiscal years 2006, 2005 and 2004, respectively, is determined by Charter provision based on similar contributions made by the ten most populous counties in California. Included in these amounts are approximately \$1,013,000, \$916,000 and \$827,000 for 2006, 2005 and 2004, respectively, to provide postretirement healthcare benefits for retired employees. The Port's liability for both current employee and post retirement health care benefits is limited to its annual contribution. The Port's contribution is paid out of current available resources and funded on a pay-as-you-go basis. Under new accounting and reporting requirements defined by GASB No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions", the City and the Port will be required to begin reporting the liability and disclosing related information for unfunded post retirement medical benefits in the Port's financial statements for the fiscal year ending June 30, 2008. The City requested its consulting actuaries to prepare a preliminary actuarial valuation of the unfunded liability as of June 30, 2006 for the City, as a whole.

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Notes to Financial Statements

d. Wellness Incentive Program

The City established in fiscal 2003, on a pilot basis, a Wellness Incentive Program (the Program) to promote workforce attendance. Under the Program, any full-time employee leaving employment of the City upon service or disability retirement may receive payment for a portion of accrued sick leave credits at the time of separation. The amount of this payment is based on two and one-half percent of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, are not included in this computation. Under collective bargaining agreements that became effective July 1, 2006, the Program continues through June 30, 2009. The estimated future payments under the Program are included in the accrued liabilities disclosed in Notes 6 and 7.

Note 11 - Related Party Transactions:

The Port receives services from, and provides services to, various City departments. The cost of services received, included as operating expenses in the financial statements, was approximately \$10,269,000 in 2006 and \$9,615,000 in 2005. Rents from City departments included in operating revenues were approximately \$3,944,000 and \$3,660,000 in 2006 and 2005, respectively. Receivables relating to such transactions are disclosed in Note 3.

Under a guaranteed payment agreement for parking fine revenues collected from Port property, the Port received \$1,200,000 from the Department of Parking and Traffic (DPT) in 2006 and 2005. Under the 1996 agreement, payments to the Port should adjust periodically as parking fines increase. The Port and DPT are discussing terms for the payment of certain incremental revenues derived from fine increases and expect resolution in fiscal year 2007.

The Port and City are in on-going discussions concerning payment to the General Fund and various City departments for services that support uses and activities within the Port area and methodologies used for the allocation of City direct and indirect costs and expenses.

**Port Commission
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Port of San Francisco**

Notes to Financial Statements

Note 12 - Commitments, Litigation and Contingencies:

a. Commitments

The Port is presently planning various development projects which involve a commitment to expend significant funds. Under an agreement with The San Francisco Bay Conservation and Development Commission finalized in 2001 (The San Francisco Waterfront Special Area Plan), the Port is committed to fund and expend up to \$30 million over a 20 year period for pier removal, parks and plazas and other public access improvements. As of June 30, 2006, \$16.7 million has been appropriated and \$1.6 million has been expended for projects under the agreement. The \$16.7 million in approved appropriations include \$9.0 million received from the sale of a portion of a seawall lot to a developer. In accordance with the development agreement and the entitlement legislation, these proceeds are restricted for the design and construction of a public plaza required by the Special Area Plan.

The Port had firm purchase and contract commitments at June 30, 2006 for approximately \$6.3 million for capital projects and \$2.0 million for general operations.

The Port has a noncancellable operating lease (sublease) for its offices at Pier 1 which requires the following minimum annual payments (in thousands):

2007	\$ 3,013
2008	3,013
2009	3,013
2010	3,013
2011	3,013
2012 - 2016	14,905
2017 - 2021	14,269
2022 - 2026	14,269
2027 - 2031	14,269
2032 - 2036	14,269
2037 - 2041	14,269
2042 - 2046	14,269
2047 - 2051	8,800
Total	\$ 124,384

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Notes to Financial Statements

The Port has an option to purchase the leasehold premises for a purchase price equal to the present value of all the remaining Base Rent due from the Port to the sublandlord through the expiration date of the sublease. Rental payments totaled \$2,644,000 in 2006 and \$2,576,000 in 2005.

b. Litigation

The Port is a defendant in various lawsuits and claims; most deal with personal injury or property damage resulting from accident or fire and are covered by insurance. In the opinion of counsel the likelihood of an unfavorable outcome is probable in some of the suits and, accordingly, accrued liabilities include the aggregate amount of deductibles under applicable insurance policies. However, a number of the lawsuits are in the discovery stages and counsel to the Port cannot express an opinion as to the possible outcome of such litigation. Port's management believes that the ultimate resolution of such matters is not expected to have a material effect on the Port's financial position or results of operations.

c. Contingencies

Risk Management

The Port is subject to various risks of loss including general liability, property and casualty, workers' compensation and employee health and accident. The Port carries commercial insurance for all risks of loss except workers' compensation, property damage to Port-owned vehicles and employee health and accident. The Port's property insurance does not cover losses due to seismic events. The Port is located in a seismically active region of California and its property is located within a liquefaction zone according to a report prepared by the California Geologic Survey. The loss of soil strength from liquefaction can cause significant damage to buildings and structures due to ground settlement or lateral spreading. In the event of a major local disaster, Federal and state emergency financial assistance should be available to cover certain costs for emergency response and repair of public facilities. Following the 1989 earthquake, the Port received \$27.8 million in federal and state emergency assistance for earthquake-related repairs.

Losses from workers' compensation claims of Port employees, the deductible portion of insured losses, and losses from other uninsured risks must be funded by current revenues or budgetary reserves. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. The administration of workers' compensation, including estimates of recorded and incurred but not reported claims, is provided by the City. The workers' compensation liability as of June 30, 2006 and 2005 has been evaluated by an independent actuary.

**Port Commission
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Notes to Financial Statements

Changes in the reported liability reserves for 2006 and 2005 resulted from the following activity:

	General Liability		Workers' Compensation	
	2006	2005	2006	2005
	(in thousands)			
Beginning of the year	\$ 1,727	\$ 2,287	\$ 2,726	\$ 3,113
Current year claims and changes in estimate	517	300	1,119	417
Settlements	(880)	(860)	(726)	(804)
End of year	\$ 1,364	\$ 1,727	\$ 3,119	\$ 2,726

The general liability and workers' compensation liability reserves are included in accrued liabilities in the financial statements.

Grants

Certain grants that the Port receives are subject to audit and final acceptance by the granting agency based upon their review of costs incurred. Port's management does not believe that such audits will have a material impact on the financial statements.

Dry Dock #1

In November 2002, a maritime vessel known as Dry Dock #1 broke free from its moorings at Pier 70 and went adrift in very high winds, finally running aground on Yerba Buena Island. The recovered dry dock is currently moored at a safer harbor location. The Port continues to evaluate options for the final disposition of this surplus vessel. Professional engineering consultants are being engaged to assess requirements for hazardous materials abatement, including potential remediation of lead-based paints, heavy-metal contaminated sediments, and asbestos. The consulting engineers will also perform a preliminary structural assessment and condition survey to assess the viability of towing the vessel from its present location to a location for ultimate disposal.

**Port Commission
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Notes to Financial Statements

Environmental

Port lands are subject to environmental risk elements typical of sites with a mix of light industrial activities dominated by transportation, transportation-related and warehousing activities. Due to the historical placement of fill of varying quality, and widespread use of aboveground and underground tanks and pipelines containing and transporting fuel, elevated levels of petroleum hydrocarbons and lead are commonly found on Port properties. Consequently, any significant construction, excavation or other activity that disturbs soil or fill material may encounter hazardous materials and/or generate hazardous waste.

The Port has identified certain environmental issues related to Port property, including asbestos removal, fuel tank removal and oil contamination. The Port may be required to perform certain clean-up work if it intends to develop or lease the property, or at such time as required by the city or state. The Port projects currently estimable testing and remediation costs to be in the range of \$0.5 million to \$0.9 million of which \$0.6 million is accrued as of June 30, 2006. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for such risk cannot be reasonably made at this time.

There is abandoned construction debris at two industrial sites in the Southern Waterfront, hindering re-leasing and use of the affected premises. A concrete batch plant ceased operations at a site north of Pier 80, abandoning approximately 17,000 cubic yards of concrete debris. Environmental conditions at this site include elevated pH levels in surface soils and groundwater and low levels of petroleum hydrocarbon contamination in the soil. The other site at Pier 94 contains approximately 100,000 tons of material, consisting primarily of concrete and asphalt debris, left behind by a bankrupt recycling operation. The Port holds a performance bond to secure the removal of the abandoned materials at Pier 94 and is in litigation with the bondholder over its obligations under the bond. Current estimates indicate that the cost of removing the debris from both sites could exceed \$1.4 million. The site near Pier 80 is being considered by the San Francisco Public Utilities Commission (SFPUC) for gas-turbine power generation facilities. It is likely that restoration and any environmental mitigation at the site could be incorporated into the SFPUC project, limiting the Port's potential liability for the abandoned materials and the environmental conditions.

PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO

JUNE 30, 2007 AND 2006

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

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**Port Commission
City and County of San Francisco
Port of San Francisco**

**Independent Auditors' Report
and Financial Statements**

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Independent Auditors' Report

THE HONORABLE EDWARD HARRINGTON
CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

We have audited the accompanying balance sheet of the **PORT COMMISSION, CITY AND COUNTY OF SAN FRANCISCO, PORT OF SAN FRANCISCO (the Port)**, an enterprise fund of the City and County of San Francisco, as of June 30, 2007 and 2006, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Port as of June 30, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 - 11 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Hood & Strong LLP

November 27, 2007

Consultants and

Business Advisors

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San Francisco

San Jose

Redwood Shores



**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

Overview of the Financial Statements

This discussion and analysis is a narrative overview and analysis of the financial activities of the Port of San Francisco (Port). It serves as an introduction to the audited financial statements, which can be found on pages 12 - 41 of this report. This overview should be read in conjunction with the more detailed information contained within the accompanying financial statements.

The Port is a self-supporting enterprise department of the City and County of San Francisco (City) and its financial statements are included in the City's Comprehensive Annual Financial Report. Only the accounts of the Port are included in the financial statements that follow. The Port Commission is responsible for seven and one-half miles of waterfront property, which was transferred in trust from the State of California to the City in 1969. The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations, which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Additional information concerning the Port's organization and the basis of presentation for this financial report is contained in Note 1 to the financial statements (pages 16 - 17).

The Balance Sheet presents information on all of the Port's assets and liabilities, with the difference between the two reported as "net assets." Increases and decreases in net assets serve as a useful indicator of the financial position of business enterprise entities like the Port. Comparative information of the Port's financial position is presented as of June 30, 2007 and 2006.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Port's net assets changed during the most recent two fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. uncollected rents from tenants and earned, but unused vacation leave).

The Statement of Cash Flows presents information about the cash receipts and cash payments of the Port during the most recent two fiscal years. This statement shows the effects on financial position of cash and non-cash operating, investing, capital, and financing transactions. When used with related disclosures and information in the other financial statements, the information in the Statement of Cash Flows helps readers assess the Port's ability to generate net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes follow the financial statements and can be found on pages 16 - 41 of this report.

Following is a presentation of certain condensed financial information derived from the basic financial statements.

**Port Commission
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Management's Discussion and Analysis

Condensed Financial Information – Port of San Francisco

Comparative Net Assets (in thousands)

	June 30,			
	2007	2006	Change	% Change
Current and other assets	\$ 105,897	\$ 90,136	\$ 15,761	17.5
Capital assets	272,362	270,124	2,238	0.8
Total assets	378,259	360,260	17,999	5.0
Long-term debt obligations	15,398	19,270	(3,872)	(20.1)
Other liabilities	33,163	33,223	(60)	(0.2)
Total liabilities	48,561	52,493	(3,932)	(7.5)
Net assets:				
Invested in capital assets, net of related debt	262,937	256,466	6,471	2.5
Restricted	154	16,758	(16,604)	(99.1)
Unrestricted	66,607	34,543	32,064	92.8
Total net assets	\$ 329,698	\$ 307,767	\$ 21,931	7.1

Changes in Net Assets (in thousands)

	Year Ended June 30,			
	2007	2006	Change	% Change
Revenues:				
Program revenues:				
Rents and other operating revenues	\$ 61,193	\$ 58,588	\$ 2,605	4.4
Capital grants and other contributions	2,224	3,460	(1,236)	(35.7)
General revenues	4,223	3,311	912	27.5
Total revenues	67,640	65,359	2,281	3.5
Total expenses	63,095	55,329	7,766	14.0
Change in net assets before Special Items	4,545	10,030	(5,485)	(54.7)
Special Items	17,386	315	17,071	5,419.4
Increase in net assets	21,931	10,345	11,586	112.0
Net assets, beginning of the year	307,767	297,422	10,345	3.5
Net assets, end of the year	\$ 329,698	\$ 307,767	\$ 21,931	7.1

**Port Commission
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Management's Discussion and Analysis

Financial Analysis

Assets exceeded liabilities by \$329,698,000 at the close of the most recent fiscal year. Total net assets as of June 30, 2007 increased \$21,931,000 from June 30, 2006. This increase follows a \$10,345,000 increase posted for the previous fiscal year. The 2007 change in net assets reflects a modest increase in net revenues of \$4,545,000 and one-time residual receipts from a developer of \$17,386,000. While there has been some increase in operating revenues, the overall net increase remains largely driven by nonrecurring revenue transactions and expense variances. The more significant variances and nonrecurring transactions are discussed below in more detail.

The largest portion of the Port's net assets, 80 percent at June 30, 2007 and 83 percent at June 30, 2006, reflects its investment in capital assets (e.g. land, buildings and equipment). The Port is responsible for a seven and one-half mile stretch of waterfront land and its revenue is derived primarily from property rentals to commercial and industrial enterprises and a diverse mix of maritime operations. As disclosed in Note 1 to the financial statements, land transferred from the State of California to the City is reported at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State to reflect appraised values in 1929. The total amount of net assets tied to capital assets (\$262,937,000 at June 30, 2007) represents assets that are not available for future spending. Although the investment in capital assets is reported net of related debt, the resources needed to repay the debt must be provided from other sources (i.e. other Port assets or operating revenues). The capital assets themselves cannot be used to liquidate those liabilities. The remaining portion of net assets at June 30, 2007 consists of \$154,000 restricted for specified capital expenditures and \$66,607,000 that is unrestricted and available to meet future capital requirements and ongoing obligations.

The Statement of Revenues, Expenses and Changes in Net Assets on page 13 presents the Port's operating revenues in more detail by industry revenue types. Operating revenues for the year ended June 30, 2007 increased \$2,605,000 or 4.4%. As set forth in Note 9 to the financial statements (page 31), overall property rentals across all revenue types posted a net increase of \$1,688,000 in 2007: \$678,000 from minimum or base rentals and \$1,010,000 from percentage rents over minimum base rents ("overage rents"). Parking-related revenues, which include lots leased to parking operators, parking stalls, parking meters on Port streets and fine revenues collected by the City on Port property, have grown steadily for the last several years.

Ship repair business at Pier 70 was strong in 2007 and the Port received additional percentage rent from the increased business. Cruise revenues returned to recent historical levels after a banner 2006 year that included 98 cruise calls.

Other Operating Revenues include permit fees, various one-time fees realized from major development projects and certain leases on Port property, grant funds received to support an operating activity and, in 2007, a \$750,000 litigated settlement. Revenues on this line fluctuate from year to year since they are largely derived from specific transactions and construction activities on Port property.

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City and County of San Francisco
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Management's Discussion and Analysis

Capital grants and other contributions consist principally of funds received or receivable from federal, state and local grant agencies which provide funding for several of the Port's capital projects. This revenue source fluctuates widely, based on grant funds availability and the capital work in progress at the Port.

All revenues not reported in the foregoing condensed summaries as Program Revenues, as defined in Government Accounting Standards Board Statement No. 34, are presented as General Revenues. General Revenues for 2007 and 2006 included interest and investment income (\$4,223,000 and \$2,993,000, respectively). In 2006, the Port also received \$307,000 in forfeitures from a contractor and \$11,000 from the disposition of equipment.

Total expenses of \$63,095,000 for 2007 represent a \$7,766,000 increase from 2006. Comparatively, total expenses for 2006 of \$55,329,000 represent a \$388,000 increase from 2005. Nonrecurring charges have accounted for many expense variances in recent years. Some regular operating budget items like workers compensation and insurance continue to fluctuate, but normalization is expected in future periods. The more significant cost and expense changes in 2007 included the following:

	<u>Increase / (Decrease)</u>
Salary and fringe benefit costs	\$ 3,201,000
Wharf J10 demolition and removal	1,228,000
Dredging expense	1,060,000
Services recoveries by other city departments, net	718,000
Depreciation and amortization	717,000
Maintenance materials and services	420,000
Rent expense	376,000
Allocated city indirect costs	265,000
Project-related consultant services	240,000
Security	210,000
Insurance premiums	143,000
Workers compensation	(1,046,000)
Cruise call secondary berth mobilization costs	(194,000)
Judgment and claims	(109,000)

Pursuant to collective bargaining agreements which became effective July 1, 2006, most of the City's represented employees received a base wage increase of 7% in exchange for paying (by payroll deduction) 7.5% of the required employee contribution amount to the San Francisco Employee Retirement System (SFERS). Since 2004, substantially all mandated employee contributions were paid to SFERS by affected employees (i.e. no "retirement pick-up" expense, realizing budget savings for the City since July 1, 2004). Most employees also received a scheduled base wage increase of 2.5% effective December 30, 2006. These two wage adjustments accounted for about one-half of the \$3.2 million increase in Port personnel costs in 2007. The balance of the expense increase is due to the filling of positions and a reduction in the amount of capitalized labor (i.e. labor captured as part of capital improvement work and excluded from operating expenses).

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Management's Discussion and Analysis

In 2004, the Port Commission adopted the findings of a nexus study that analyzed the balance of payments between the Port and City. That study established a record of certain past expenditures and provided a systematic means for determining the balance of payments for future periods. The Port and City continue to evaluate and refine the methodologies used for the allocation of certain City costs and expenses. In 2007, total net reimbursements to other city departments for services increased by \$718,000 over 2006. The larger reimbursement increases were to the City Attorney's Office for legal and litigation-related services, the Fire Department for fireboat operations and maintenance, and the Controller's Office for internal audit services.

The passenger cruise business at the Port of San Francisco has grown in recent years, with multiple vessel calls on many more dates. Historically, the Port had supplemented the two berths at the Pier 35 cruise terminal by activating Piers 30-32 for berthing. Under its contract, the Port's marine terminal operator for Pier 35 mobilizes and services supplemental berthing facilities on a reimbursement basis. Among other things, the open-pier operation at Piers 30-32 requires tents, fences and barricades. To accommodate 2007 vessel calls at Pier 27, certain dredging was completed and a new fendering system installed on the north side of Pier 27. On an on-going basis, it is less expensive to mobilize Pier 27's berth and a portion of the covered shed as a supplemental berthing facility. The \$194,000 cost decrease in 2007 is due both to the cost savings realized by utilizing Pier 27 and fewer secondary mobilizations in 2007.

Special Items identify significant transactions or events within the control of management that are either unusual in nature or infrequent in occurrence. This line item includes \$17,386,000 in residual receipts received from a developer in 2007 and the final \$315,000 from a \$29,700,000 use fee paid by the San Francisco Municipal Transportation Agency for the permanent right to use certain Port land in 2006. Additional information on these items is contained in Note 12 on page 37.

Capital Asset and Debt Administration

Capital assets. The Port's investment in capital assets as of June 30, 2007 amounts to \$272.4 million, net of accumulated depreciation. This investment in capital assets includes land, certain street and road improvements, pier promenades, pier substructure, buildings and related improvements, vehicles, equipment and furniture. There was a modest level of acquisition and construction activity in 2007. Additional information on the Port's capital assets can be found in Note 4 on pages 24 - 25 of this report.

Major capital asset events of fiscal 2007 and 2006 included the following:

- *Pier 27 Floating Fender System.* A floating fender system was installed along the south berth of Pier 27 to make it suitable for large-vessel berthing. Pier 27 is a cost-effective secondary berth supporting the Pier 35 Cruise Terminal during multiple vessel calls. This \$0.4 million project was completed in time for the Queen Mary II, the largest cruise ship to call at San Francisco.
- *Pier 94 Wetlands Enhancement.* This \$0.3 million project focused on improvement of habitat quality and beautification of an approximately five-acre salt marsh along the northeastern shoreline of Pier 94, including certain earthwork to increase wetland acreage within the existing area.

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**Port Commission
City and County of San Francisco
Port of San Francisco**

Management's Discussion and Analysis

-
- *Security fencing.* Funding provided from the Department of Homeland Security's Urban Area Security Initiative and the State of California Homeland Security grant programs funded \$0.9 million of replacement fencing at multiple Port facilities. The new fencing assists the Port toward compliance with security mandates applicable to facilities regulated under the Maritime Transportation Act of 2002.
 - *TSA port security projects.* The Transportation Security Administration (TSA) provided funding for three projects to enhance facility and operational security at the Port's cruise, ferry and cargo facilities. Including costs funded locally, the Port expended \$4.3 million for the Pier 35 cruise passenger terminal. Another \$0.9 million was expended for gate and access control projects at the Downtown Ferry Terminal and the Pier 80 cargo terminal.
 - *Ferry Terminal Public Pier.* This \$2.4 million project connected a freestanding breakwater at the Downtown Ferry Terminal with the Embarcadero Promenade and added public pedestrian improvements to the top of a breakwater. Pedestrians can now walk out over the Bay; fish; view interpretative signage about ferry activities, Bay currents and habitat; observe ferry operations in the adjacent harbor; and enjoy views of the City and the Bay Bridge.
 - *Substructure repairs at Piers 1 ½ - 5.* The developer-tenant completed significant substructure repairs and upgrades as part of certain initial improvements specified in the Lease Disposition and Development Agreement and is entitled to the maximum allowable rent credit of \$10.0 million, to be amortized against certain rents due under the lease commencing April 2006.
 - *Pier 52 Parking Lot Improvements.* This \$0.5 million project provides for a parking lot with 40 spaces capable of handling vehicles with trailers and a small timber structure to house an oil recycling shed.
 - *Amador Street Extension.* This \$0.5 million project provides a temporary paved access road to link Piers 90-92 and Piers 94-96. The roadway will relieve vehicle congestion at Cargo Way and Third Street, and improve vehicle access to Port tenants located at Piers 90-92.
 - *Illinois Street Intermodal Bridge.* The bridge is constructed over Islais Creek and extends Illinois Street from the north side of the creek, adjacent to the Pier 80 cargo terminal, to Pier 90 on the south side of the creek. Completion of this project will provide replacement freight rail service to Pier 80 previously accessed via Potrero Way at 16th Street. The bridge will also provide for two-way vehicular traffic across the bridge, opening of the bridge for watercraft in the creek, and bicycle and pedestrian access across the Bridge. The construction timetable for the South Approach has been extended due to unforeseen conditions and related additional work requirements. This \$27 million project is now projected to be completed in early 2008.

At June 30, 2007, \$37.4 million remain appropriated and available to be expended for various capital projects, including pier repair and major maintenance or improvements. Facility condition surveys are performed by Port Engineering to identify and prioritize immediately required maintenance projects that preserve and extend the economic life of the Port's productive assets.

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In accordance with the City's Administrative Code Section 2.30, the Port updated its ten-year capital plan in 2007. This update resulted in the identification of 677 capital projects, totaling more than \$1.4 billion. Potential funding has only been identified for 34% of the total. Approximately \$1 billion are in unfunded projects – projects for which the Port (1) does not expect to have sufficient funds to cover the estimated costs to repair and upgrade the facility, and (2) has not issued an RFP or entered into negotiations with a developer to finance the upgrades. Several funding options may exist to address this unmet need, such as development projects and grant opportunities. However, the Port has not secured any of those options. Each new funding option will require substantial staff time to develop and implement as well as support from policy makers and, in the case of potential development projects, the support of the California State Lands Commission and the San Francisco Bay Conservation and Development Commission.

The Port has entered into a number of public/private partnerships with developers for the historical preservation, renovation, and redevelopment of Port properties. Current information concerning major development projects and opportunities can be found at the Port's website: www.sfport.com. Some of the more significant development project activities and events of 2007 and 2006 include:

Rincon Park Restaurants – This project requires the construction of two new restaurants on the northeastern waterfront at the south end of Rincon Park along the Embarcadero Promenade. Construction commenced in August 2006; anticipated completion and opening is in late 2007.

Piers 1½ - 5 – This project entails rehabilitation of historic bulkhead buildings with ground floor restaurants, upper floor office, public access walkways and guest boat dock. Shell construction has been completed. Subleasing is underway in 2007.

Bryant Street Piers Mixed Use and Cruise Terminal Development – The Lease Disposition and Development Agreement ("LDDA") between the Port and the developer expired in September 2006, without the developer exercising an option to extend the term of the LDDA. Significant project entitlements remain in place. The project contemplated a mixed use development with a two-berth cruise ship terminal, ground floor retail and restaurant, and upper floor office and entertainment uses on Piers 30-32. A residential condominium tower project (Phase 1), built on a portion of Seawall Lot 330 sold to the developer, was completed in April 2006 and substantially all of the 136 residential units were sold by June 2007. Concept design for the Phase 2 bayfront urban park on The Embarcadero between Piers 30-32 and Pier 38 ("Brannan Street Wharf") was also completed.

In connection with the original Piers 30-32 mixed-use cruise terminal development project, and as approved by state legislation in 2001 (Assembly Bill No. 1389), a portion of Seawall Lot No. 330 was sold for \$9,324,000 to the developer in 2004. Under the original development agreement, certain proceeds from the land sale (\$9,000,000) were specifically committed to the construction of a public plaza area called Brannan Street Wharf. The remaining land sale proceeds of \$324,000, together with certain residual receipts from the sale of residential condominium units built on the land sold, were also committed to the project area for the construction of the cruise terminal and the Brannan Street Wharf. Residual receipts totaling \$17,386,000 were received through June 30, 2007. A blue-ribbon advisory panel, formed in 2006 by the Port's Executive Director to assist in a review and update of the Port's cruise terminal project goals and objectives, presented its findings to the Port Commission in September, 2007. Among other things, the panel recommended consideration of Pier 27 for a new terminal.

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Management's Discussion and Analysis

Other development projects are in various stages of review and negotiation under exclusive rights (ERN) agreements. The Port Commission approved assignment of the ERN for a mixed-use recreation project at Piers 27-31 to a new developer in March 2006. Negotiations continue for a revised development memorandum. The revised project plan could, in addition to a variety of adaptive new uses (indoor and outdoor recreation, marine sports basin, restaurants, marine and recreation-oriented retail, and a small amount of offices) include cruise ship berthing. The Exploratorium, a museum of science, art and human perception, is considering leasing and rehabilitating portions of Piers 15-17. The Board of Supervisors passed a resolution in June 2005 exempting the potential lease from the competitive bidding process required by Administrative Code Section 2.6-1. The Port Commission approved an ERN with The Exploratorium in February 2006. A City-required fiscal feasibility report was approved by the Board of Supervisors in July 2006. Environmental review of the project is underway at the Department of City Planning.

Development and planning activities are also being directed at Seawall Lot No. 337, master planning for the Pier 70 Opportunity Area, and preliminary feasibility analyses for environmental, engineering and economic viability of development in the Piers 90-94 Backlands.

The Port has been pursuing State legislative changes to increase funding options to address future capital requirements. In 2005, the Port sought legislative authorization to establish an infrastructure financing district. The infrastructure district law allows public agencies to finance public infrastructure improvements by capturing and bonding against tax increment generated in the district after it is established. Senate Bill No. 1085, signed by Governor Arnold Schwarzenegger in September 2005, amended the California Government Code to authorize public trust grantees in San Francisco to form infrastructure financing districts pursuant to Section 53395 et seq. This legislative amendment incorporates changes that enable the City and Port to apply this law to the Port area. Among other things, it authorizes the use of such districts for urban waterfront areas in addition to undeveloped or underdeveloped areas; specifically clarifies that publicly-owned property subject to tidelands trust for commerce, navigation and fisheries (the "public trust"), including filled tidelands, may be included in such districts; and enumerates additional examples of infrastructure improvements that qualify for infrastructure financing districts, including seismic upgrades, historic renovation, environmental remediation, utility improvements, structural repair or construction of seawalls, piers and wharves. A multi-step process must be followed to establish the actual infrastructure financing district. These future steps include defining the boundaries of a district, developing the infrastructure plan and obtaining approval from the Board of Supervisors.

In October 2007, Governor Arnold Schwarzenegger signed Senate Bill No 815. This new legislation authorizes the lifting of public trust use restrictions on specified seawall lots and the removal of the public trust on certain paper streets.

The City's ten-year Capital Plan has programmed two \$150 million general obligation bond measures for park projects over the next five years. The first bond proposal, 2008 Clean and Safe Neighborhood Parks, has been increased to \$185 million and includes \$32.8 million for open space projects on Port property. The bond measure will appear on the February 5, 2008 ballot.

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Management's Discussion and Analysis

Long-term obligations. Detailed information concerning the Port's long-term obligations can be found in Note 8 on pages 27 - 31 of this report. As of June 30, 2007, the Port had total long-term obligations of \$15,398,000 including \$4,158,000 that is due during the next fiscal year. Long-term obligations consist of \$12,203,000 in revenue bonds and \$3,195,000 in loans that are secured by specified revenue sources. As discussed in Note 8, the Port issued new refunding revenue bonds in August 2004 to current refund the outstanding Series 1994 Revenue Bonds. The term of the bonds was not extended. The current refunding was completed to take advantage of lower interest rates, reducing total debt service over the remaining five years of the issue (through July 1, 2009). No other debt has been issued.

Economic and Other Factors

Economy. Amidst general uncertainties concerning the national economic condition, continuing gradual economic recovery has occurred in the local San Francisco economy. A focus on homeland security since the acts of terrorism on September 11, 2001 initially reduced tourist travel and tourist-dependent sales venues in the City. The Port's restaurant and retail tenants in general have recovered and continue to report steadily increasing sales activity. Commercial office vacancies in 2007 are reportedly at the lowest since 2000 and office rents in the central business district are rising. The Port has been able to maintain its minimum rent roll at approximately \$3.4 million per month and a majority of the Port's property rentals are covered by term leases. Note 9 (page 32) contains required financial statement disclosure information covering the future rental income stream from minimum rents over the noncancellable term of active operating leases. Revenue loss to the Port during down periods has been generally limited to some decline in overage rents (percentage rents above the minimum) and some increase in delinquencies. The Port expects to be able to maintain revenues at current levels with modest year-to-year growth.

While the revenue side reflects recovery, the broader economic climate retains a great deal of uncertainty and challenges on the cost side continue to arise: fuel costs, steel and other construction material costs, supply chain disruptions due to natural or man-made disasters, etc. General economic conditions are taken into consideration when preparing budgets and forecasts.

San Francisco Waterfront Special Area Plan. In July 2000, the Port agreed to amend its Waterfront Land Use Plan, and the San Francisco Bay Conservation and Development Commission (BCDC) its San Francisco Bay Plan to create consistent plans for the waterfront area between the Hyde Street Pier and China Basin (San Francisco Waterfront Special Area Plan). Among other things, the Special Area Plan commits the Port to expend up to \$30 million over a 20-year period for the removal of certain piers and the construction of major public plazas and other public access improvements. The Port is permitted to seek and use other funding sources (i.e. grants and contributions) to finance the required pier removals and public access improvements. Until sufficient funding from other sources is secured, the Port may need to commit significant capital funds in future years for Special Area Plan projects. As of June 30, 2007, \$16.7 million has been appropriated and \$1.6 million has been expended for projects under the agreement. Assembly Bill No. 1389, signed by former Governor Gray Davis in October 2001 to authorize approval of the development plans for a cruise ship terminal at Piers 30-32, also ratified the San Francisco Waterfront Special Area Plan adopted by the Port and BCDC.

**Port Commission
City and County of San Francisco
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Management's Discussion and Analysis

Port security. The Port participates in a regional Port Security Committee, which reviews security issues and needs affecting ports and terminals in the San Francisco Bay Area. Since 2005, the Port has had a full-time homeland security manager responsible for developing, directing, overseeing and implementing a comprehensive security program mandated by the federal government.

Under the Port Security Grants Program, managed by the Transportation Security Administration, the Port of San Francisco received a first round grant to conduct a comprehensive security assessment study of its waterfront facilities. Subsequently, the Port was awarded a total of \$3.9 million in second and third round funding for certain capital improvements that improve facility and operational security at the Port's cruise, ferry and cargo facilities. As a department of the City and as a California port, the Port of San Francisco has been allocated funds from other Department of Homeland Security programs to plan for and to implement effective response to emergent threats to Port and City property.

Requests for Information

This report is designed to provide a general overview of the Port of San Francisco's finances. The financial statements and related informative disclosures in the notes to the financial statements and required supplementary information is presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Public Information Officer at Port of San Francisco, Pier 1, San Francisco, California, 94111.

Questions concerning the City and County of San Francisco or requests for a copy of the City's Comprehensive Annual Financial Report should be addressed to: Office of the Controller, City and County of San Francisco, at City Hall, Room 316, 1 Dr. Carlton B. Goodlett Place, San Francisco, California 94102.

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**Port Commission
City and County of San Francisco
Port of San Francisco**

**Balance Sheet
(in thousands)**

<i>June 30,</i>	2007	2006
Assets		
Current Assets:		
Cash and investments, held in City Treasury - Port operating fund	\$ 80,688	\$ 66,073
Cash outside of City Treasury	5	5
Receivables - net	6,889	5,369
Materials and supplies	1,245	1,152
Prepaid insurance and other assets	37	38
Total current assets	88,864	72,637
Restricted Assets:		
Cash held in City Treasury:		
Lessee deposits	5,638	4,081
Capital outlay	151	447
Bond interest and redemption held by trustee	6,550	6,420
Other - Lessee deposits	790	732
Total restricted assets	13,129	11,680
Capital Assets - net	272,362	270,124
Other Assets	3,904	5,819
Total assets	\$ 378,259	\$ 360,260
Liabilities		
Current Liabilities Payable from Current Assets:		
Accounts payable and accrued liabilities	\$ 10,941	\$ 11,432
Current maturities of long-term obligations	88	84
Accrued interest payable	132	135
Total current liabilities	11,161	11,651
Current Liabilities Payable from Restricted Assets:		
Current maturities of revenue bonds	4,070	3,975
Accrued bond interest payable	202	251
Lessee deposits	6,428	4,813
Deferred grants		7
Total payable from restricted assets	10,700	9,046
Noncurrent Liabilities	3,624	3,886
Deferred Revenue - Net of current portion	11,836	12,699
Long-term Obligations - Net of current maturities	11,240	15,211
Total liabilities	48,561	52,493
Net Assets:		
Invested in capital assets, net of related debt	262,937	256,466
Restricted	154	16,758
Unrestricted	66,607	34,543
Total net assets	329,698	307,767
Total liabilities and net assets	\$ 378,259	\$ 360,260

THE UNIVERSITY OF CHICAGO
DEPARTMENT OF CHEMISTRY
JANUARY 1964

MEMORANDUM

TO: THE CHAIRMAN, DEPARTMENT OF CHEMISTRY

FROM: DR. [Name]

SUBJECT: [Topic]

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**Port Commission
City and County of San Francisco
Port of San Francisco**

**Statement of Revenues, Expenses and Changes in Net Assets
(in thousands)**

<i>Years Ended June 30,</i>	2007	2006
Operating Revenues:		
Commercial and industrial	\$ 36,496	\$ 35,803
Parking	10,514	9,122
Cargo	4,152	4,181
Fishing	1,760	1,609
Ship repair	1,332	1,105
Harbor services	887	1,003
Cruise	1,763	2,065
Other maritime	1,391	1,272
Other	2,898	2,428
Total operating revenues	61,193	58,588
Operating Expenses:		
Operations and maintenance	50,887	44,893
Depreciation and amortization	10,253	9,536
Total operating expenses	61,140	54,429
Operating income	53	4,159
Other Income (Expense):		
Interest and investment income	4,223	2,993
Interest expense	(797)	(900)
Other		307
Gain (loss) from disposition of assets	(1,158)	11
Total nonoperating revenues and expenses	2,268	2,411
Capital Contributions - Capital grants and other contributions	2,224	3,460
Special Items	17,386	315
Change in Net Assets	21,931	10,345
Net Assets - beginning of the year	307,767	297,422
Net Assets - end of the year	\$ 329,698	\$ 307,767

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Statement of Cash Flows
(in thousands)**

<i>Years Ended June 30,</i>	2007	2006
Cash Flows from Operating Activities:		
Cash received from tenants for rent	\$ 51,481	\$ 49,519
Cash received from customers and others	7,457	7,915
Deposits received from tenants and customers	1,619	638
Cash paid to employees for services	(24,085)	(20,903)
Cash paid to suppliers for goods and services	(13,204)	(9,646)
Cash paid for quasi-external transactions	(11,114)	(10,269)
Customer deposits returned	(160)	(276)
Net cash provided by operating activities	11,994	16,978
Cash Flows from Noncapital Financing Activities -		
Forfeiture income		307
Net cash provided by noncapital financing activities		307
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment	(12,877)	(16,160)
Dredging	(245)	(3,623)
Payments of long-term debt	(4,059)	(3,470)
Interest payments on long-term debt	(600)	(705)
Residual receipts received from a development project	17,386	
Capital grants received	2,079	3,809
Proceeds from sale of equipment and materials	70	11
Pier demolition and other asset disposition costs	(1,228)	
Proceeds from a land sale		324
Net cash used by capital and related financing activities	526	(19,814)
Cash Flows from Investing Activities -		
Interest income received	3,448	2,984
Net cash provided by investing activities	3,448	2,984
Net Increase in Cash and Cash Equivalents	15,968	455
Cash and Cash Equivalents - Beginning of year	75,177	74,722
Cash and Cash Equivalents - End of year	\$ 91,145	\$ 75,177

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Statement of Cash Flows (In Thousands)
(Continued)**

<i>Years Ended June 30,</i>	2007	2006
Noncash Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment included in accounts payable and accrued liabilities	\$ 920	\$ 1,895
Tenant improvements financed by rent credit	589	10,947
Noncash Investing Activities:		
Change in fair value of cash and investments held in City Treasury	\$ 10	\$ (81)
Change in fair value of U.S. Treasury Note held by bond trustee	28	(87)
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income	\$ 53	\$ 4,159
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	10,253	9,536
Change in allowance for doubtful accounts	142	156
Net change in deferred revenue	(233)	345
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables	(773)	(1,212)
Materials and supplies	(93)	22
Prepaid insurance and other assets	2,098	1,679
Increase (decrease) in:		
Accounts payable and accrued liabilities	(1,010)	1,964
Lessee deposits	1,557	329
Net cash provided by operating activities	\$ 11,994	\$ 16,978
Reconciliation of Cash and Cash Equivalents to the Balance Sheet:		
Cash and investments held in City Treasury - Port operating fund	\$ 80,688	\$ 66,073
Cash deposit outside of City Treasury	5	5
Cash held in City Treasury:		
Lessee deposits	5,638	4,081
Capital outlay	151	447
Cash held by Trustee - Bond interest and redemption (see Note 2)	4,617	4,515
	91,099	75,121
Fair value adjustment, cash and investments held in City Treasury	46	56
Cash and Cash Equivalents	\$ 91,145	\$ 75,177

Memorandum
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**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

Note 1 - Significant Accounting Policies:

a. Basis of Presentation

The Port of San Francisco (Port) is an enterprise fund of the City and County of San Francisco (City). Only the accounts of the Port are included in these financial statements. There are no component units that should be considered for inclusion in the Port's financial reporting entity.

A five-member Port Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for fixed terms of four years. The Port is an integral part of the City, and the accompanying financial statements are included in the City's Comprehensive Annual Financial Report.

Prior to February 1969, the Port was owned by the State of California ("State") and administered by the San Francisco Port Authority, a State agency. In February 1969, the State transferred the Port in trust to the City under the terms and conditions specified in the State statutes of 1968, Chapter 1333 ("Burton Act"), as amended, and ratified by the City's voters in November 1968.

Under the terms of the Burton Act, the State Legislature reserved the right to amend, modify, or revoke, in whole or in part, the transfer of lands in trust, provided that the State would then assume all lawful obligations related to such lands.

The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Substantially all of the Port's property rental customers are located within the boundaries of the City. Port revenues are held in a separate fund ("Harbor Fund") and are appropriated for expenditure pursuant to the budget and fiscal provisions of the City Charter, consistent with trust requirements. Under public trust doctrine, the Burton Act, and the transfer agreement between the City and the State, these revenues may be spent only for uses and purposes of the public trust.

1. The first part of the paper discusses the importance of the study.

2. The second part of the paper discusses the methodology.

3. Results and Discussion

3.1. Results

The results of the study are presented in this section. The first part of the results section discusses the findings of the study.

The second part of the results section discusses the findings of the study.

The third part of the results section discusses the findings of the study.

The fourth part of the results section discusses the findings of the study.

The fifth part of the results section discusses the findings of the study.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

The Port's financial statements are prepared using the economic resources measurement focus and the accrual basis in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the Port applies all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred.

In accordance with GASB Statement No. 34 (GASB 34) "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," the balance sheet presents the difference between assets and liabilities as net assets. Net assets are reported in three broad components, as applicable – invested in capital assets, net of related debt; restricted; and unrestricted. Under the all-inclusive approach to presenting the changes in net assets, all Port revenues, including capital contributions, are reported in the statement of revenues, expenses and changes in net assets.

b. Cash and Investments

The Port reports its investments at fair value based upon quoted market prices. Fair value is defined as the amount that the Port could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short term investments are reported at cost (or amortized cost), which approximates fair value. For purposes of the statement of cash flows, all unrestricted and restricted cash and highly liquid investments with maturities of three months or less, when purchased, are considered to be cash equivalents. In addition, the Port considers its deposits with the City Treasurer (see Note 2) to be demand deposits and therefore cash for the purposes of the statement of cash flows.

c. Materials and Supplies

Materials and supplies are used for construction and maintenance of Port facilities and are stated at average cost.

d. Restricted Assets

Cash security deposits received by the Port pursuant to lease agreements are held in the City Treasury. Other lessee deposits are renewable certificates of deposit tendered by tenants in lieu of cash and held by banks as third-party certificates in the name of the Port. Other lessee deposits also include deposits receivable pursuant to adjustment provisions in the leases.

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**Port Commission
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Notes to Financial Statements

Bond interest and redemption represent funds accumulated for debt service payments due in the next twelve months and reserve funds set aside to make up potential future deficiencies. A bond trustee holds these funds.

Capital outlay funds are restricted for use in construction and acquisition of equipment, due to restrictions from federal and state grant agreements and bond resolutions.

e. Capital Assets

Land transferred to the City in February 1969 is stated at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State in prior years to reflect appraised values in 1929.

Other capital assets are carried at cost or at fair market value at the date received in the case of property received by donation or by termination of a lease. Donated surplus equipment received from the federal government is carried at an estimated value determined in accordance with federal guidelines. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets. Land improvements (principally pavement and pier promenades) with a cost of approximately \$20 million are not depreciated because, in the opinion of management, the assets will be maintained to provide indefinite useful lives. Building (tenant) improvements are amortized using the straight-line method over the shorter of the estimated life of the asset or the remaining term of the related lease. Maintenance and repairs are expensed as incurred.

Interest paid on bond funds used for construction purposes, less interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, if applicable, is capitalized from the date of borrowing through the construction period.

f. Other Assets

Bond issue costs are amortized using the straight-line method over the life of the bond. Original bond issue premiums are offset against the related debt and amortized using the straight-line method over the life of the bonds.

Dredging costs are amortized using the straight-line method over the estimated useful period ranging from one to seven years.

Waterfront Land Use Plan (Plan) costs are amortized using the straight-line method over an estimated life of 20 years. The Plan was approved by the City Board of Supervisors in September 1997.

1. The first part of the paper discusses the importance of the study and the objectives of the research.

2. The second part of the paper discusses the methodology used in the study.

3. The third part of the paper discusses the results of the study and the conclusions drawn from the data.

4. The fourth part of the paper discusses the implications of the study and the recommendations for future research.

5. The fifth part of the paper discusses the limitations of the study and the strengths of the research.

6. The sixth part of the paper discusses the contributions of the study to the field of research.

7. The seventh part of the paper discusses the ethical considerations of the study and the measures taken to ensure the integrity of the research.

8. The eighth part of the paper discusses the future directions of the research and the potential for further exploration.

9. The ninth part of the paper discusses the acknowledgments and the funding sources of the study.

10. The tenth part of the paper discusses the references and the sources used in the study.

11. The eleventh part of the paper discusses the appendices and the additional information provided.

12. The twelfth part of the paper discusses the conclusion and the final thoughts on the study.

13. The thirteenth part of the paper discusses the bibliography and the list of references.

14. The fourteenth part of the paper discusses the index and the table of contents.

15. The fifteenth part of the paper discusses the glossary and the definitions of the terms used.

16. The sixteenth part of the paper discusses the list of figures and the tables included in the study.

17. The seventeenth part of the paper discusses the list of abbreviations and the symbols used.

18. The eighteenth part of the paper discusses the list of acronyms and the full names of the organizations.

19. The nineteenth part of the paper discusses the list of footnotes and the additional information.

20. The twentieth part of the paper discusses the list of references and the sources used in the study.

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Notes to Financial Statements

g. Deferred Revenue

Deferred revenue consists primarily of rent credits issued to customers. Deferred revenue is recognized in accordance with the lease agreements and is amortized using the straight-line method over the term of the specific leases.

h. Refunding Debt

The Port's 1994 revenue refunding bonds were current refunded in August 2004 (see Note 8). The difference between the reacquisition price and the net carrying amount of the old debt is deferred and together with the unamortized difference from the 1994 refunding is reported as a reduction of the bonds payable. The total deferred amount is being amortized on a straight-line basis over the remaining life of the bonds through July 1, 2009.

i. Operating Revenues and Expenses

The Port distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from the real estate, maritime and other principal ongoing activities of the Port's normal business operations. Real estate revenues consist principally of rentals of Port property to industrial, commercial, retail, office and other business enterprises. Maritime revenues are derived from vessel operations, warehousing, ship repair, harbor services and other maritime activities. Vessel operations include dry, liquid bulk, and break bulk cargoes, cruise, and other berthing. Other operating revenues include building permit and inspections fees. Operating expenses include facility maintenance, the cost of operations, administrative expenses and depreciation and amortization on capital assets. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Minimum base rental revenue is normally recognized on the straight-line basis over related lease terms. Most term leases provide that rents be payable to the Port in equal monthly installments on the first day of each month until terminated. Contingent rentals are recorded or accrued only for periods in which the contingent thresholds for gross sales or revenues are met. Use fees are recorded when the Port fee is determined based on actual occupancy or use. Fees are assessed by a measured unit (e.g. lineal feet of vessel for dockage) and/or measured time (e.g. per twenty-four hour day). Maritime activity or use fees may be based on a standardized tariff schedule or covered by specific contractual agreements.

Grants and similar revenue items are recognized as revenue as soon as all eligibility requirements have been met.

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j. Capital Contributions

The Port, at various times, receives federal and state grants and other funds from external sources for construction of waterfront facilities. The funds are reported as capital contributions on the Statement of Revenues, Expenses and Changes in Net Assets.

k. Special Items

Significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence are reported separately as special items on the Statement of Revenues, Expenses and Changes in Net Assets

l. Environmental Expenses

The Port incurs costs associated with environmental clean-up which arise during the normal course of business. These costs are recorded as a liability when the Port is required to perform the clean-up. Environmental liabilities are accrued when it is probable that obligations have been incurred and the associated amounts can be reasonably estimated.

m. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2 - Cash and Investments:

The Port maintains its operating fund cash and investments and a portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The Comprehensive Annual Financial Report of the City provides more detailed information concerning deposit and investment risks associated with the City's pool of cash and investments at June 30, 2007.

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The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer, subject to review by the Treasury Oversight Committee. The Treasury Oversight Committee, established under California Government Code Sections 27130 to 27137, is composed of various City officials and representatives of agencies with large cash balances. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The provisions of the City's investment policy also address interest rate risk, credit risk, custodial credit risk and concentration of credit risk and provides for additional restrictions related to investments. Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City Treasurer manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. Credit risk is that risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The City's pool is not registered with the SEC as an investment company and is not rated. Custodial credit risk for investments is that risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments; however, it is the practice of the City Treasurer that all investments are insured, registered or held by the Treasurer's custodial agent in the City's name. To address concentration of credit risk, the policy specifies authorized investment types and sets parameters for maximum maturity, maximum percentage of the total portfolio which may be invested in specific investment types, and maximum investment to one issuer for certain investment types. U.S. Treasury and Agency securities are not subject to this limitation.

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Custodial credit risk for deposits is that risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging authorized securities as collateral. The fair value of pledged securities must equal at least 110 percent of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2007, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

The following table shows the percentage distribution of the City's pooled investments by maturity:

Investment maturities (in months)			
Under 1	1 – 6	6 – 12	12 – 36
25.9%	43.6%	28.4%	2.1%

The Port's cash and investments, reported at fair value, at June 30, 2007 and 2006 are as follows:

	2007	2006
	(in thousands)	
Cash and investments in City Treasury	\$ 80,688	\$ 66,073
Cash outside of City Treasury	5	5
Restricted assets:		
Cash and investments in City Treasury	5,789	4,528
Deposits and investments outside City Treasury:		
Cash and investments held by bond trustee	6,550	6,420
Lessee deposits	621	612
	<u>\$ 93,653</u>	<u>\$ 77,638</u>

Lessee security deposits are held on behalf of the Port by third party trustees and invested in renewable certificates of deposit. These deposits, made by tenants and customers directly to banks, are held outside of the City Treasury and are not collateralized as public agency deposits. One uncollateralized account for \$167,000 exceeds the federal insurance limit.

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At June 30, 2007 and 2006, cash and investments held in reserve and for debt service payments by trustee consist of:

	2007	2006
	(in thousands)	
Reserve Fund:		
U.S. Treasury Money Market Fund	\$ 213	\$ 162
U.S. Treasury Note, due June 15, 2009	1,933	1,905
Debt Service Funds -		
U.S. Treasury Money Market Fund	4,404	4,353
	<u>\$ 6,550</u>	<u>\$ 6,420</u>

Investment of all funds and accounts held by the bond trustee are governed by the Bond Indenture rather than the general provisions of the California Government Code or the City's investment policy. Investments held by the bond trustee consist of a single U.S. Treasury note maturing in 2009 in the Reserve Fund and shares of a registered money market fund. Although other investment types are permitted by the Indenture, their use is not anticipated. The money market fund has a Standard & Poor's rating of AAAM.

Note 3 - Receivables:

At June 30, 2007 and 2006, receivables consisted of:

	2007	2006
	(in thousands)	
Trade accounts receivable	\$ 5,115	\$ 5,238
Less allowance for doubtful accounts	(2,000)	(1,858)
	3,115	3,380
Grants receivable	1,571	1,410
Accrued interest receivable	1,203	466
Other	1,000	113
	<u>\$ 6,889</u>	<u>\$ 5,369</u>

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Note 4 - Capital Assets:

At June 30, 2007 and 2006, capital assets consisted of:

	2007 (in thousands)	2006	Estimated Useful Life (Years)
Land and land improvements	\$ 121,045	\$ 120,454	
Buildings, structures and related improvements	295,610	282,503	5 - 64
Furniture, machinery and equipment	14,915	14,359	2 - 20
<u>Total</u>	<u>431,570</u>	<u>417,316</u>	
<u>Less accumulated depreciation</u>	<u>(193,170)</u>	<u>(183,103)</u>	
	238,400	234,213	
<u>Construction work in progress</u>	<u>33,962</u>	<u>35,911</u>	
<u>Total</u>	<u>\$ 272,362</u>	<u>\$ 270,124</u>	

Total interest cost was \$547,000 and \$651,000 for fiscal years 2007 and 2006. Total interest earned was \$4,212,000 and \$3,081,000 for fiscal years 2007 and 2006. No interest cost and earnings were capitalized in 2007 and 2006.

The buildings, structures and improvements identified above include pier substructures, which have an estimated useful life greater than 50 years. Such long-lived assets total \$21,915,000 as of June 30, 2007 and 2006.

The cost of fully depreciated assets still in use was approximately \$92,448,000 at June 30, 2007, including \$86,440,000 in buildings, structures and improvements and \$6,008,000 in furniture, machinery and equipment.

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The following is a summary of changes in capital assets for the year ended June 30, 2007 (in thousands):

	Balance June 30, 2006	Increases	Decreases	Balance June 30, 2007
Land and land improvements	\$ 120,454	\$ 591	\$ -	\$ 121,045
Buildings, structures and related improvements	282,503	13,107		295,610
Furniture, machinery and equipment	14,359	741	185	14,915
Total	417,316	14,439	185	431,570
Construction work in progress	35,911	11,474	13,423	33,962
	<u>453,227</u>	<u>25,913</u>	<u>13,608</u>	<u>465,532</u>
Less accumulated depreciation for:				
Buildings, structures and related improvements	173,900	9,239		183,139
Furniture, machinery and equipment	9,203	1,013	185	10,031
Total accumulated depreciation	183,103	10,252	185	193,170
Total	\$ 270,124	\$ 15,661	\$ 13,423	\$ 272,362

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Note 5 - Other Assets:

Other assets at June 30, 2007 and 2006, net of related amortization, consisted of:

	2007	2006
	(in thousands)	
Deferred debt	\$ 126	\$ 189
Dredging costs	1,882	3,521
Waterfront land use plan	1,690	1,855
Note receivable	85	125
Other deferred costs	121	129
	<u>\$ 3,904</u>	<u>\$ 5,819</u>

The note receivable is the long-term portion of a five-year installment payment agreement with a City department. In connection with a former subtenant and operator of a municipal tow yard on Port property, the Port and the City department agreed to a five-year monthly payment plan for certain rents still due to the Port upon termination of the towing contract by the City in 2005. The Port Commission approved the installment payment plan for total outstanding rents of \$193,191 plus interest at 2% per annum.

Note 6 - Accounts Payable and Accrued Liabilities:

At June 30, 2007 and 2006, accounts payable and accrued liabilities consisted of:

	2007	2006
	(in thousands)	
Accounts payable	\$ 2,815	\$ 4,457
Current portion of deferred revenue	2,151	932
Accrued liabilities	3,830	4,173
Accrued payroll, compensated absences and related costs	2,145	1,870
	<u>\$ 10,941</u>	<u>\$ 11,432</u>

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Notes to Financial Statements

Note 7 - Noncurrent Liabilities:

At June 30, 2007 and 2006 noncurrent liabilities consisted of:

	2007	2006
	(in thousands)	
Compensated absences and related costs	\$ 855	\$ 808
Workers' compensation	2,269	2,564
Litigation, claims and judgments	500	514
	<u>\$ 3,624</u>	<u>\$ 3,886</u>

Note 8 - Long-Term Obligations:

Long-term obligations at June 30, 2007 and 2006 consisted of the following:

	Interest Rate (%)	Last Series Matures	Balance 2007	2006
			(in thousands)	
Revenue bonds	2.25 - 4.00	July 1, 2009	\$ 12,203	\$ 15,991
Loan payable	4.50	August 1, 2028	3,195	3,279
Total long-term obligations			15,398	19,270
Less current maturities			(4,158)	(4,059)
Net long-term obligations			<u>\$ 11,240</u>	<u>\$ 15,211</u>

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The following is a summary of changes in long-term obligations for the years ended June 30, 2007 and 2006 (in thousands):

	Revenue Bonds	Loan	Total
Balances as of June 30, 2005	\$ 19,195	\$ 3,359	\$ 22,554
Current maturities, retirements and other decreases, net	(3,204)	(80)	(3,284)
Balances as of June 30, 2006	15,991	3,279	19,270
Current maturities, retirements and other decreases, net	(3,788)	(84)	(3,872)
Balances as of June 30, 2007	\$ 12,203	\$ 3,195	\$ 15,398

The annual payments required for all outstanding long-term obligations are as follows (in thousands):

Year Ending June 30:	Revenue Bonds		Other Long Term Obligations		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2008	\$ 4,070	\$ 348	\$ 88	\$ 144	\$ 4,158	\$ 492
2009	4,185	222	92	140	4,277	362
2010	4,320	75	96	136	4,416	211
2011			100	131	100	131
2012			105	127	105	127
2013 – 2017			600	559	600	559
2018 – 2022			748	411	748	411
2023 – 2027			932	227	932	227
2028 – 2029			434	29	434	29
Total	\$ 12,575	\$ 645	\$ 3,195	\$ 1,904	\$ 15,770	\$ 2,549

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Bonds

Bond obligations at June 30, 2007 and 2006 consisted of the following:

	Interest Rate (%)	Last Series Matures	Balance	
			2007 (in thousands)	2006
Revenue Bonds -				
Series 2004	2.25 - 4.00	July 1, 2009	\$ 12,575	\$ 16,550
Less:				
Current maturities			(4,070)	(3,975)
Unamortized bond premium			152	227
Deferred amount on refunding			(524)	(786)
Net Bond Obligations			\$ 8,133	\$ 12,016

In August 2004, the Port issued \$19,940,000 in Revenue Refunding Bonds, Series 2004 with an average interest rate of 3.16% to current refund \$23,175,000 of outstanding Series 1994 Revenue Bonds with an average coupon rate of 5.84%. Net proceeds from the new bonds plus an additional \$3.9 million of Series 1994 debt service monies were used to defease the 1994 bonds. The Port completed the current refunding to reduce its total debt service payments over the subsequent five years by \$1.6 million and to obtain an economic gain (difference between the present value of the old and new debt service payments) of \$1.2 million. The 1994 bonds refunded \$49,975,000 of outstanding 1984 Revenue Bonds, Series A, B and C with an average interest rate of 8.4 percent.

The refunding resulted in a difference between the reacquisition price (principal of the old debt plus 2% call premium) and the net carrying amount of the old debt of \$0.5 million. The previous 1994 refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$2.36 million. The total difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through July 1, 2009 using the straight line method.

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The revenue bonds are secured by a pledge of Net Revenues of the Port, as defined by the Revenue Bond Indenture. Under the terms of the Indenture, as amended, the Port is required to deposit with a trustee in a reserve fund, an amount equal to the lesser of (a) maximum debt service accruing in any year during the life of such bonds, (b) ten percent (10%) of the proceeds derived from the sale of Series 2004 Bonds, or (c) 1.25 times the average annual debt service due with respect to Series 2004 Bonds. At June 30, 2007, the Port was in compliance with this bond indenture requirement.

While Series 2004 Bonds are outstanding, the Port may not create liens on its property essential to operations, dispose of any property essential to maintaining revenues or operating the Port, and must maintain specified insurance. The Port may issue additional bonds under the Indenture provided the Port complies with the Additional Bonds Test, as defined in the Indenture.

Covenants of the Indenture, as amended, include that the Port will maintain its business operations, and establish and maintain rentals, rates, fees, and charges for the use of Port property and for services rendered by the Port so that the Net Revenue, as defined in the bond indenture, in each fiscal year will be at least equal to 130% of aggregate annual debt service for such fiscal year. At June 30, 2007, the Port was in compliance with such bond covenants.

The Series 2004 Revenue Bonds are subject to an arbitrage rebate requirement. The requirements stipulate, in general, that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The cumulative arbitrage liability as of June 30, 2007 was approximately \$143,000.

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Notes to Financial Statements

Loan

The Port has entered into a loan agreement with the California Department of Boating and Waterways (Cal Boating) for \$3.5 million to finance certain Hyde Street Harbor improvements. The loan is subordinate to all bonds payable by the Port. Interest accrues at a rate of 4.5% per annum on the unpaid balance commencing with the first draw on the loan. The term is 30 years from the date of the first draw, which occurred in April 1998. The loan is secured by Gross Revenues as defined in the loan agreement. The project was completed as scheduled in 2002 and annual payments commenced on August 1, 2002.

	2007	2006
	(in thousands)	
Loan payable to Cal Boating	\$ 3,195	\$ 3,279
Less current portion	(88)	(84)
<u>Net loan payable</u>	<u>\$ 3,107</u>	<u>\$ 3,195</u>

Note 9 - Operating Revenues - Property Rentals:

Certain property rental agreements specify rental payments based on a percentage of tenant sales, subject to a minimum amount. Property rental revenues were comprised as follows:

	2007	2006
	(in thousands)	
Minimum rentals	\$ 41,497	\$ 40,819
Percentage rentals	10,836	9,826
	<u>\$ 52,333</u>	<u>\$ 50,645</u>

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Notes to Financial Statements

Minimum future rental income under noncancellable operating leases having terms in excess of one year are as follows:

<u>Year Ending June 30</u>	(in thousands)
2008	\$ 27,550
2009	24,964
2010	21,900
2011	18,894
2012	18,262
2013 - 2017	79,933
2018 - 2022	67,936
2023 - 2027	54,743
2028 - 2032	49,331
2033 - 2037	44,740
2038 - 2042	30,310
2043 - 2047	21,821
2048 - 2052	14,992
2053 - 2057	7,900
2058 - 2062	7,023
2063 - 2067	6,709
2068	4
<u>Total</u>	<u>\$ 497,012</u>

The approximate cost of property subject to operating leases and property held for lease at June 30, 2007 consisted of:

	(in thousands)
Land and land improvements	\$ 52,473
Buildings, structures, and related improvements at cost, less accumulated depreciation of \$158,959	70,107
<u>Total</u>	<u>\$ 122,580</u>

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Notes to Financial Statements

Note 10 - Employee Benefit Plans:

a. Retirement Plans

City and County of San Francisco

Plan Description - The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Port along with other employees of the City. The Plan provides basic service retirement, disability and death benefits based on specified percentages of defined final average salary and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, California 94102 or by calling (415) 487-7020.

Funding Policy - Contributions are made to the basic plan by both the Port and its employees. Employee contributions are mandatory. Employee contribution rates for 2007, 2006 and 2005 varied from 7.0% to 8.0% as a percentage of covered payroll. The Port is required to contribute at an actuarially determined rate which was 6.24% for June 30, 2007, 6.58% for the year ended June 30, 2006, and 4.48% for the year ended June 30, 2005. The Port's employer contributions amounted to \$1,133,000 and \$1,056,000 and \$702,000 for 2007, 2006 and 2005, respectively. The Port's contributions to the Retirement System on behalf of its employees amounted to \$148,000, \$199,000, and \$3,000, for the years ended June 30, 2007, 2006 and 2005, respectively. In 2005, substantially all required employee contributions were paid to the Retirement System by such affected employees. For those groups of employees not mandated by collective bargaining agreements to contribute to the Retirement System, the Port's contributions remained at 7.0% to 8.0% of covered payroll.

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State of California

Plan Description - The Port also contributed to the California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the state of California. Certain employees who commenced their employment at the Port prior to February 1969 were eligible to participate in PERS. There are no actively employed participants in the plan. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

Funding Policy - Participating employees are required to contribute 7 percent of their salary to PERS. The Port is required to contribute the remaining amounts necessary to fund the benefits for its members, using the actuarial basis recommended by PERS actuaries and actuarial consultants and adopted by the Board of Administration.

There were no contributions required in 2007, 2006 or 2005. The City's Comprehensive Annual Financial Report contains disclosures for all covered City employees. Amounts for the Port are not separable from the City totals in those disclosures.

b. Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code (IRC) Section 457. The Plan, available to all Port employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

In accordance with GASB Statement No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans", Plan assets and related liabilities to Plan participants are not included in the City's financial statements. The City has no fiduciary accountability for the Plan. It has no administrative involvement and does not perform the investing function.

The amounts deferred by Port employees totaled \$1,217,000, \$1,166,000 and \$969,000 for 2007, 2006 and 2005, respectively.

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Notes to Financial Statements

c. Health Care Benefits

Health care benefits of Port employees, retired employees and surviving spouses are financed by beneficiaries and by the City principally through the City and County of San Francisco Health Service System. The annual contribution to the city health plan is determined by Charter provision based on similar contributions made by the ten most populous counties in California. The Health Service System issues a publicly available financial report that includes financial statements and supplementary information for the health care benefits. That report may be obtained by writing to the San Francisco Health Service System, 1145 Market Street, 2nd Floor, San Francisco, CA 94103 or by calling (415) 554-1700.

As noted above in Note 10a, certain employees who commenced their employment at the Port prior to February 1969 were eligible to participate in PERS. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

The Port's contribution for health care benefits, which amounted to approximately \$3,252,000, \$2,941,000 and \$2,665,000 in fiscal years 2007, 2006 and 2005, respectively, is determined by Charter provision based on similar contributions made by the ten most populous counties in California. Included in these amounts are approximately \$1,235,000, \$1,013,000 and \$916,000 for 2007, 2006 and 2005, respectively, to provide postretirement healthcare benefits for retired employees. The Port's liability for both current employee and post retirement health care benefits is limited to its annual contribution. The Port's contribution is paid out of current available resources and funded on a pay-as-you-go basis. Under new accounting and reporting requirements defined by GASB No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions", the City and the Port will be required to begin reporting the liability and disclosing related information for unfunded post retirement medical benefits in the Port's financial statements for the fiscal year ending June 30, 2008. The City is working with its consulting actuaries to evaluate the unfunded liability as of June 30, 2006 for the City as a whole, and individual City departments/enterprise funds such as the Port. The Port has yet to determine the impact GASB No. 45 will have on its financial statements.

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Notes to Financial Statements

d. Wellness Incentive Program

The City established in fiscal year 2003, on a pilot basis, a Wellness Incentive Program (the Program) to promote workforce attendance. Under the Program, any full-time employee leaving employment of the City upon service or disability retirement may receive payment for a portion of accrued sick leave credits at the time of separation. The amount of this payment is based on two and one-half percent of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, are not included in this computation. Under collective bargaining agreements that became effective July 1, 2006, the Program continues through June 30, 2009. The estimated future payments under the Program are included in the accrued liabilities disclosed in Notes 6 and 7.

Note 11 - Related Party Transactions:

The Port receives services from, and provides services to, various City departments. The cost of services received, included as operating expenses in the financial statements, was approximately \$11,114,000 in 2007 and \$10,269,000 in 2006. Rents from City departments included in operating revenues were approximately \$3,853,000 and \$3,944,000 in 2007 and 2006, respectively. Receivables relating to such transactions are disclosed in Note 3.

The Port continues to evaluate its payments to the General Fund and various City departments for services that support uses and activities within the Port area and work with the City to refine the methodologies used for the allocation of City direct and indirect costs and expenses.

Under a 1996 agreement with the City for parking fine revenues collected from Port property, the Port received \$1,600,000 from the Municipal Transportation Agency (MTA) in 2007 and \$1,200,000 in 2006. During 2007, the Port and MTA negotiated an amendment to the original agreement. Among other things, the amendment effective July 1, 2007 provides for the transfer to the Port of actual parking fines collected on Port property and the reimbursement by the Port of all MTA's costs associated with collecting and processing parking fines issued on Port property.

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Notes to Financial Statements

Note 12 - Special Items

In connection with the original Piers 30-32 mixed-use cruise terminal development project, and as approved by state legislation in 2001 (Assembly Bill No. 1389), a portion of Seawall Lot No. 330 was sold to the developer. The first phase of the development project, a residential condominium tower on the land sold, was completed in 2006. Certain residual receipts from the sale of residential condominium units accrue to the Port. Substantially all of the condominium units have been sold and the Port has received proceeds of \$17,386,000 through June 30, 2007.

In 2001, the Port entered into an agreement giving the San Francisco Municipal Transportation Agency (MUNI) the permanent right to use certain land for its Metro East Maintenance and Operations Facility. MUNI paid a total use fee of \$29,700,000 for these property rights. A portion of the fee (\$4,000,000) was restricted for the construction of a new rail bridge and was initially recorded as deferred revenue. Construction on the bridge commenced in 2005 and deferred amounts have been recognized as revenue, including \$315,000 for the fiscal year ended June 30, 2006.

Note 13 - Commitments, Litigation and Contingencies:

a. Commitments

The Port is presently planning various development projects which involve a commitment to expend significant funds. Under an agreement with The San Francisco Bay Conservation and Development Commission finalized in 2001 (The San Francisco Waterfront Special Area Plan), the Port is committed to fund and expend up to \$30 million over a 20-year period for pier removal, parks and plazas and other public access improvements. As of June 30, 2007, \$16.7 million has been appropriated and \$1.6 million has been expended for projects under the agreement. The \$16.7 million in approved appropriations include \$9.0 million received from the sale of a portion of Seawall Lot 330 to the developer. After expiration of the original development agreement in 2006, the land sale proceeds of \$9.0 million remain designated for the design and construction of a public plaza required by the Special Area Plan.

The Port had firm purchase and contract commitments at June 30, 2007 for approximately \$5.6 million for capital projects and \$1.8 million for general operations.

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The Port has a noncancellable operating lease (sublease) for its offices at Pier 1 which requires the following minimum annual payments (in thousands):

2008	\$ 3,105
2009	3,105
2010	3,105
2011	3,105
2012	3,105
2013 - 2017	15,301
2018 - 2022	14,730
2023 - 2027	14,730
2028 - 2032	14,730
2033 - 2037	14,730
2038 - 2042	14,730
2043 - 2047	14,730
2048 - 2050	6,138
Total	\$ 125,344

The Port has an option to purchase the leasehold premises for a purchase price equal to the present value of all the remaining Base Rent due from the Port to the sublandlord through the expiration date of the sublease. Rental payments totaled \$2,984,000 in 2007 and \$2,644,000 in 2006.

b. Litigation

The Port is a defendant in various lawsuits and claims; most deal with personal injury or property damage resulting from accident or fire and are covered by insurance. In the opinion of counsel the likelihood of an unfavorable outcome is probable in some of the suits and, accordingly, accrued liabilities include the aggregate amount of deductibles under applicable insurance policies. However, a number of the lawsuits are in the discovery stages and counsel to the Port cannot express an opinion as to the possible outcome of such litigation. Port's management believes that the ultimate resolution of such matters is not expected to have a material effect on the Port's financial position or results of operations.

**Port Commission
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Notes to Financial Statements

c. Contingencies

Risk Management

The Port is subject to various risks of loss including general liability, property and casualty, workers' compensation and employee health and accident. The Port carries commercial insurance for all risks of loss except workers' compensation, property damage to Port-owned vehicles and employee health and accident. The Port's property insurance does not cover losses due to seismic events. The Port is located in a seismically active region of California and its property is located within a liquefaction zone according to a report prepared by the California Geologic Survey. The loss of soil strength from liquefaction can cause significant damage to buildings and structures due to ground settlement or lateral spreading. In the event of a major local disaster, Federal and state emergency financial assistance should be available to cover certain costs for emergency response and repair of public facilities. Following the 1989 earthquake, the Port received \$27.8 million in federal and state emergency assistance for earthquake-related repairs.

Losses from workers' compensation claims of Port employees, the deductible portion of insured losses, and losses from other uninsured risks must be funded by current revenues or budgetary reserves. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. The administration of workers' compensation, including estimates of recorded and incurred but not reported claims, is provided by the City. The workers' compensation liability as of June 30, 2007 and 2006 has been evaluated by an independent actuary.

Changes in the reported liability reserves for 2007 and 2006 resulted from the following activity:

	General Liability		Workers' Compensation	
	2007	2006	2007	2006
	(in thousands)			
Beginning of the year	\$ 1,364	\$ 1,727	\$ 3,119	\$ 2,726
Current year claims and changes in estimate	162	517	100	1,119
Settlements	(426)	(880)	(472)	(726)
End of year	\$ 1,100	\$ 1,364	\$ 2,747	\$ 3,119

The general liability and workers' compensation liability reserves are included in accrued liabilities in the financial statements.

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Grants

Certain grants that the Port receives are subject to audit and final acceptance by the granting agency based upon their review of costs incurred. Port's management does not believe that such audits will have a material impact on the financial statements.

Drydock #1

In November 2002, a maritime vessel known as Drydock #1 broke free from its moorings at Pier 70 and went adrift in very high winds, finally running aground on Yerba Buena Island. The recovered drydock is currently moored at a safer harbor location. The Port continues to evaluate options for the final disposition of this surplus vessel. Engineering consultants have assessed requirements for hazardous materials abatement, including potential remediation of lead-based paints, heavy-metal contaminated sediments, and asbestos. The consulting engineers also performed a preliminary structural assessment and condition survey to assess the viability of towing the vessel from its present location to a location for ultimate disposal. Based on its poor condition, the drydock is most likely only salvageable for scrap metal.

Environmental

Port lands are subject to environmental risk elements typical of sites with a mix of light industrial activities dominated by transportation, transportation-related and warehousing activities. Due to the historical placement of fill of varying quality, and widespread use of aboveground and underground tanks and pipelines containing and transporting fuel, elevated levels of petroleum hydrocarbons and lead are commonly found on Port properties. Consequently, any significant construction, excavation or other activity that disturbs soil or fill material may encounter hazardous materials and/or generate hazardous waste.

The Port has identified certain environmental issues related to Port property, including asbestos removal, fuel tank removal and oil contamination. The Port may be required to perform certain clean-up work if it intends to develop or lease the property, or at such time as required by the city or state. The Port projects currently estimable testing and remediation costs to be in the range of \$0.6 million to \$0.7 million of which \$0.6 million is accrued as of June 30, 2007. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for such risk cannot be reasonably made at this time.

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The Port is coordinating with Pacific Gas and Electric Company (PG&E) for the removal of fuel pipelines at two Southern Waterfront locations. One pipeline, located at Pier 70 Wharf 8, provided fuel oil to the former PG&E Potrero Power Plant. The other is an abandoned PG&E pipeline discovered at the Illinois Street Bridge project site near Pier 90, extending south from Islais Creek to the former Hunters Point Power Plant. The PG&E pipeline removal at Pier 70 is expected to be completed by December 2007 and the other by Summer 2008.

There is abandoned construction debris at two industrial sites in the Southern Waterfront, hindering re-leasing and use of the affected premises. A concrete batch plant ceased operations at a site north of Pier 80, abandoning approximately 17,000 cubic yards of concrete debris. Environmental conditions at this site include elevated pH levels in surface soils and groundwater and low levels of petroleum hydrocarbon contamination in the soil. The other site at Pier 94 contains approximately 100,000 tons of material, consisting primarily of concrete and asphalt debris, left behind by a bankrupt recycling operation. The Port has been in litigation with the surety, seeking enforcement of its rights under a performance bond for the removal of materials left at the Pier 94 site. In May 2007, the Port received a judgment award for the full bond amount of \$650,000, plus costs and interest. The surety filed a notice of appeal; but in September 2007, the surety entered into a settlement agreement under which the Port was paid \$750,000, consistent with the previous court judgment, and agreed to dismiss its appeal. The Port is assessing options for processing and removal of the debris.

The site near Pier 80 is being considered by the San Francisco Public Utilities Commission (SFPUC) for gas-turbine power generation facilities. It is likely that restoration and any environmental mitigation at the site would be incorporated into the SFPUC project, limiting the Port's potential liability for the abandoned materials and the environmental conditions.

PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO

JUNE 30, 2008 AND 2007

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AND

FINANCIAL STATEMENTS

**Port Commission
City and County of San Francisco
Port of San Francisco**

**Independent Auditors' Report
and Financial Statements**

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Independent Auditors' Report

MR. BEN ROSENFELD
CONTROLLER
CITY AND COUNTY OF SAN FRANCISCO

We have audited the accompanying balance sheet of the **PORT COMMISSION, CITY AND COUNTY OF SAN FRANCISCO, PORT OF SAN FRANCISCO (the Port)**, an enterprise fund of the City and County of San Francisco, as of June 30, 2008 and 2007, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Port as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 - 12 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Hood & Strong LLP

December 10, 2008

Consultants and

Business Advisors

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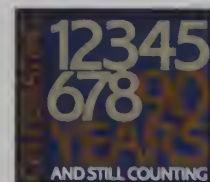
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**Port Commission
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Management's Discussion and Analysis

Overview of the Financial Statements

This discussion and analysis is a narrative overview and analysis of the financial activities of the Port of San Francisco (Port). It serves as an introduction to the audited financial statements, which can be found on pages 13 - 42 of this report. This overview should be read in conjunction with the more detailed information contained within the accompanying financial statements.

The Port is a self-supporting enterprise department of the City and County of San Francisco (City) and its financial statements are included in the City's Comprehensive Annual Financial Report. Only the accounts of the Port are included in the financial statements that follow. The Port Commission is responsible for seven and one-half miles of waterfront property, which was transferred in trust from the State of California to the City in 1969. The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations, which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Additional information concerning the Port's organization and the basis of presentation for this financial report is contained in Note 1 to the financial statements (pages 17 - 18).

The Balance Sheet presents information on all of the Port's assets and liabilities, with the difference between the two reported as "net assets." Increases and decreases in net assets serve as a useful indicator of the financial position of business enterprise entities like the Port. Comparative information of the Port's financial position is presented as of June 30, 2008 and 2007.

The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Port's net assets changed during the most recent two fiscal years. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. uncollected rents from tenants and earned, but unused vacation leave).

The Statement of Cash Flows presents information about the cash receipts and cash payments of the Port during the most recent two fiscal years. This statement shows the effects on financial position of cash and non-cash operating, investing, capital, and financing transactions. When used with related disclosures and information in the other financial statements, the information in the Statement of Cash Flows helps readers assess the Port's ability to generate net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

The Notes to Financial Statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes follow the financial statements and can be found on pages 17 - 42 of this report.

Following is a presentation of certain condensed financial information derived from the basic financial statements.

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Management's Discussion and Analysis

Condensed Financial Information – Port of San Francisco

Comparative Net Assets (in thousands)

	June 30,			2008 - 2007	2007 - 2006
	2008	2007	2006	Change	Change
Current and other assets	\$ 105,205	\$ 105,897	\$ 90,136	\$ (692)	\$ 15,761
Capital assets	275,058	272,362	270,124	2,696	2,238
Total assets	380,263	378,259	360,260	2,004	17,999
Long-term debt obligations	11,426	15,398	19,270	(3,972)	(3,872)
Other liabilities	38,150	33,163	33,223	4,987	(60)
Total liabilities	49,576	48,561	52,493	1,015	(3,932)
Net assets:					
Invested in capital assets, net of related debt	269,936	262,937	256,466	6,999	6,471
Restricted	617	154	16,758	463	(16,604)
Unrestricted	60,134	66,607	34,543	(6,473)	32,064
Total net assets	\$ 330,687	\$ 329,698	\$ 307,767	\$ 989	\$ 21,931

Changes in Net Assets (in thousands)

	Year Ended June 30,			2008 - 2007	2007 - 2006
	2008	2007	2006	Change	Change
Revenues:					
Program revenues:					
Rents and other operating revenues	\$ 64,498	\$ 61,193	\$ 58,588	\$ 3,305	\$ 2,605
Capital grants and other contributions	3,942	2,224	3,460	1,718	(1,236)
General revenues	3,614	4,223	3,311	(609)	912
Total revenues	72,054	67,640	65,359	4,414	2,281
Total expenses	71,263	63,095	55,329	8,168	7,766
Change in net assets before Special Items	791	4,545	10,030	(3,754)	(5,485)
Special Items	198	17,386	315	(17,188)	17,071
Increase in net assets	989	21,931	10,345	(20,942)	11,586
Net assets, beginning of the year	329,698	307,767	297,422	21,931	10,345
Net assets, end of the year	\$ 330,687	\$ 329,698	\$ 307,767	\$ 989	\$ 21,931

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Management's Discussion and Analysis

Financial Analysis

Assets exceeded liabilities by \$330,687,000 at the close of the most recent fiscal year. Total net assets as of June 30, 2008 increased \$989,000 from June 30, 2007. This increase follows a \$21,931,000 increase posted for the previous fiscal year. Revenues in 2007 included one-time residual receipts from a developer of \$17,386,000. While there has been some increase in operating revenues, the overall net increase remains largely driven by nonrecurring revenue transactions and expense variances. The more significant variances and nonrecurring transactions are discussed below in more detail.

The largest portion of the Port's net assets, 82 percent at June 30, 2008 and 80 percent at June 30, 2007, reflects its investment in capital assets (e.g. land, buildings and equipment). The Port is responsible for a seven and one-half mile stretch of waterfront land and its revenue is derived primarily from property rentals to commercial and industrial enterprises and a diverse mix of maritime operations. As disclosed in Note 1 to the financial statements, land transferred from the State of California to the City is reported at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State to reflect appraised values in 1929. The total amount of net assets tied to capital assets (\$269,936,000 at June 30, 2008) represents assets that are not available for future spending. Although the investment in capital assets is reported net of related debt, the resources needed to repay the debt must be provided from other sources (i.e. other Port assets or operating revenues). The capital assets themselves cannot be used to liquidate those liabilities. The remaining portion of net assets at June 30, 2008 consists of \$617,000 restricted for specific expenditures and \$60,134,000 that is unrestricted and available to meet future capital requirements and ongoing obligations.

The Statement of Revenues, Expenses and Changes in Net Assets on page 14 presents the Port's operating revenues in more detail by industry revenue types. Operating revenues for the year ended June 30, 2008 increased \$3,305,000 or 5.4%, which is slightly higher than the \$2,605,000 or 4.4% increase for the year ended June 30, 2007. As set forth in Note 9 to the financial statements (page 32), overall property rentals across all revenue types posted a net increase of \$4,208,000 in 2008: \$3,311,000 from minimum or base rentals and \$897,000 from percentage rents over minimum base rents ("overage rents"). Parking-related revenues, which include lots leased to parking operators, parking stalls, parking meters on Port streets and fine revenues collected by the City on Port property, have also grown steadily in recent years. Cruise revenues have dropped after a peak in 2006 which had 98 cruise calls. There were 47 and 71 cruise calls in 2008 and 2007, respectively. In 2007, ship repair business at Pier 70 was very strong and the Port received additional percentage rent from the increased business.

Other Operating Revenues include permit fees, various one-time fees realized from major development projects and certain leases on Port property and grant funds received to support an operating activity. Revenues on this line fluctuate from year to year since they are largely derived from specific transactions and construction activities on Port property. Also in 2008, reimbursements of \$562,000 were received or accrued for the costs incurred by the Port in connection with the November 7, 2007 COSCO Busan oil spill. In 2007, Other Revenues included proceeds of \$750,000 from a litigated settlement.

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Management's Discussion and Analysis

Capital grants and other contributions consist principally of funds from federal, state and local grant agencies which provide funding for several of the Port's capital projects. This revenue source fluctuates widely, based on grant funds availability and the capital work actually in progress at the Port.

All revenues not reported in the foregoing condensed summaries as Program Revenues, as defined in Governmental Accounting Standards Board Statement No. 34, are presented as General Revenues. General Revenues for 2008 and 2007 included interest and investment income (\$3,613,000 and \$4,223,000, respectively). In 2008, the Port also received \$1,000 from the disposition of equipment.

Total expenses of \$71,263,000 for 2008 represent a \$8,168,000 increase from 2007. Comparatively, total expenses of \$63,095,000 for 2007 represented a \$7,766,000 increase from 2006. Nonrecurring charges have accounted for many expense variances in recent years. Some regular operating budget items like workers compensation and insurance continue to fluctuate, but normalization is expected in future periods. The more significant cost and expense changes in 2008 and 2007 included the following:

	<u>Increase / (Decrease)</u>	
	2008	2007
Postemployment benefits other than pensions	\$ 2,805,000	
Asset disposition, pier demolition and project abandonment	2,539,000	\$ 1,228,000
Salary and fringe benefit costs	1,144,000	3,201,000
Environmental and related	880,000	31,000
Cosco Busan oil spill response costs other than payroll	476,000	
Workers compensation	450,000	(1,046,000)
Services of other city departments	369,000	1,071,000
Project-related consultant services	186,000	240,000
Depreciation and amortization	154,000	717,000
Office rent expense	53,000	376,000
Insurance premiums	49,000	143,000
Security	13,000	210,000
Allocated city indirect costs	(943,000)	265,000
Dredging expense	(226,000)	935,000

In accordance with an accounting requirement effective June 30, 2008, a \$2.8 million charge was recorded in 2008 for retiree benefits other than pensions (i.e. retiree medical benefits). Currently, these retiree benefits are funded on a "pay-as-you-go" basis. In accordance with the new accounting standard, the City has allocated the annual required contribution computed by consulting actuaries proportionately to departments based on the current payroll costs of covered employees.

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Pursuant to collective bargaining agreements which became effective July 1, 2006, most of the City's represented employees received a base wage increase of 7% in exchange for paying (by payroll deduction) 7.5% of the required employee contribution amount to the San Francisco Employee Retirement System (SFERS). Since 2004, substantially all mandated employee contributions were paid to SFERS by affected employees (i.e. no "retirement pick-up" expense, realizing budget savings for the City since July 1, 2004). Most employees also received a scheduled base wage increase of 2.5% effective December 30, 2006. These wage adjustments accounted for about one-half of the \$3.2 million increase in Port personnel costs in 2007. Expense increases in 2008 and other increases in 2007 were attributable to various factors, including the filling of positions, temporary salaries, higher benefit costs, and reductions in the amount of capitalized labor (i.e. labor captured as part of capital improvement work and excluded from operating expenses).

In 2004, the Port Commission adopted the findings of a nexus study that analyzed the balance of payments between the Port and City. That study established a record of certain past expenditures and provided a systematic means for determining the balance of payments for future periods. The Port and City continue to evaluate and refine the methodologies used for the allocation of certain City costs. Most services are settled directly through the City's interdepartmental work order process. Total service reimbursements to other city departments were \$11,035,000 in 2008 and \$11,114,000 in 2007.

Special Items identify significant transactions or events within the control of management that are either unusual in nature or infrequent in occurrence. This line item includes \$198,000 in 2008 and \$17,386,000 in 2007 of residual receipts received from a developer. The final \$315,000 from a \$29,700,000 use fee paid by the San Francisco Municipal Transportation Agency for the permanent right to use certain Port land was recognized in 2006.

Capital Asset and Debt Administration

Capital assets. The Port's investment in capital assets as of June 30, 2008 amounts to \$275.1 million, net of accumulated depreciation. This investment in capital assets includes land, certain street and road improvements, pier promenades, pier substructure, buildings and related improvements, vehicles, equipment and furniture. Additional information on the Port's capital assets can be found in Note 4 on pages 25 - 26 of this report.

Major capital asset events of fiscal 2008 and 2007 included the following:

- *Illinois Street Intermodal Bridge.* This \$27 million bridge is constructed over Islais Creek and extends Illinois Street from the north side of the creek, adjacent to the Pier 80 cargo terminal, to Pier 90 on the south side of the creek and provides for replacement freight rail service to Pier 80 previously accessed via Potrero Way at 16th Street. The bridge also provides for two-way vehicular traffic across the bridge, opening of the bridge for watercraft in the creek, and bicycle and pedestrian access across the Bridge.

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Management's Discussion and Analysis

-
- *Pier 52 Boat Launch Facility.* This \$3.5 million project resulted in a new public boat launch at Pier 52. It replaces a single-lane facility built in the 1950s. The new facility includes a two-lane boat launch, a fully accessible landing float, loading floats, lighting and signage and shoreline protection and improvements. A parking lot was completed previously for \$0.5 million; it includes 40 spaces capable of handling vehicles with trailers and a small timber structure to house an oil recycling shed.
 - *Marine Structural Repair Projects.* A number of structural repair projects totaling \$3.2 million were completed in 2007-08. Apron repairs were completed at Pier 9 North, Pier 35 North, Pier 48 South, and for Pier 50 Shed A, as well as a portion of the Fisherman's Wharf seawall northwest of Pier 49 and the gallery columns at Pier 35.
 - *Pier 35 Repair and Improvement Projects.* Various repair and improvement projects totaling \$2.8 million were completed or placed in service in 2007-08: repair to the bulkhead facade, ADA-compliant restroom upgrades, conference room renovation, guardrail upgrades, and certain roofing work.
 - *Pier 33 Roofing and Related Structural Repair Project.* This \$2.4 million project scope included re-roofing the shed, dry-rot repairs to wood decking and structural framing, repairs and refurbishing of the rooftop light monitors, window replacements and required hazardous material abatement.
 - *Pier 27 Floating Fender System.* A floating fender system was installed along the south berth of Pier 27 to make it suitable for large-vessel berthing. Pier 27 is a secondary berth supporting the Pier 35 Cruise Terminal during multiple vessel calls. This \$0.4 million project was completed in time for the Queen Mary II, the largest cruise ship to ever call at San Francisco.
 - *Security Fencing.* Funding provided from the Department of Homeland Security's Urban Area Security Initiative and the State of California Homeland Security grant programs funded \$0.9 million of replacement fencing at multiple Port facilities. The new fencing assists the Port toward compliance with security mandates applicable to facilities regulated under the Maritime Transportation Act of 2002. Additional security fence improvements are being programmed, with the project work anticipated to commence in 2009.
 - *TSA Port Security Projects.* The Transportation Security Administration (TSA) provided funding for three projects to enhance facility and operational security at the Port's cruise, ferry and cargo facilities. Including costs funded locally, the Port expended \$4.3 million for the Pier 35 cruise passenger terminal. Another \$0.9 million was expended for gate and access control projects at the Downtown Ferry Terminal and the Pier 80 cargo terminal.
 - *Pier 94 Wetlands Enhancement.* This \$0.3 million project focused on improvement of habitat quality and beautification of an approximately five-acre salt marsh along the northeastern shoreline of Pier 94, including certain earthwork to increase wetland acreage within the existing area.

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- *Amador Street Extension.* This \$0.5 million project provides a temporary paved access road to link Piers 90-92 and Piers 94-96. The roadway will relieve vehicle congestion at Cargo Way and Third Street, and improve vehicle access to Port tenants located at Piers 90-92.

At June 30, 2008, \$31.8 million remain appropriated and available to be expended for various capital projects, including pier repair and major maintenance or improvements. Select facility condition surveys are performed by Port Engineering to identify and prioritize immediately required maintenance projects that preserve and extend the economic life of the Port's productive assets.

In accordance with the City's Administrative Code Section 2.30, the Port updated its ten-year capital plan in 2008. The most current update resulted in the identification of capital projects totaling more than \$1.9 billion, including \$0.4 billion in planned capital renewal. Potential funding sources have been identified for approximately 41% of the total. Approximately \$1.1 billion are in unfunded projects – projects for which the Port (1) does not expect to have sufficient funds to cover the estimated costs to repair and upgrade the facility, and (2) has not issued an RFP or entered into negotiations with a developer to finance the upgrades. Several funding options may exist to address this unmet need, such as future development projects and grant opportunities. Each new funding option will require substantial staff time to develop and implement as well as support from policy makers and, in the case of potential development projects, the support of the California State Lands Commission and the San Francisco Bay Conservation and Development Commission.

The Port has pursued State legislative changes to increase funding options to address future capital requirements. Senate Bill No. 1085, signed by Governor Arnold Schwarzenegger in September 2005, amended the California Government Code to authorize public trust grantees in San Francisco to form infrastructure financing districts pursuant to Section 53395 et seq. This legislative amendment incorporates changes that enable the City and Port to apply this code section to the Port area. Among other things, it authorizes the use of an infrastructure financing district for urban waterfront areas in addition to undeveloped or underdeveloped areas; specifically clarifies that publicly-owned property subject to tidelands trust for commerce, navigation and fisheries (the "public trust"), including filled tidelands, may be included in such districts; and enumerates additional examples of infrastructure improvements that qualify for infrastructure financing districts, including seismic upgrades, historic renovation, environmental remediation, utility improvements, structural repair or construction of seawalls, piers and wharves. Infrastructure financing districts is a mechanism public agencies use to finance public infrastructure improvements by capturing and bonding against tax increment generated in the district after it is established. Future steps include: defining the boundaries of a district, developing the infrastructure plan and obtaining approval from the Board of Supervisors. In October 2007, Governor Arnold Schwarzenegger signed Senate Bill No 815 which authorizes the lifting of public trust use restrictions on specified seawall lots for a certain period of time ending January 1, 2094 and the removal of the public trust on certain paper streets. The lifting of public trust use restrictions on the lots increases the options for capital investment and future revenue. Revenues from "nontrust" leases beyond a defined baseline must be expended for the preservation of historic piers and historic structures or for the construction and maintenance of certain waterfront plazas and open space.

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The City's ten-year Capital Plan has programmed general obligation bond funding for park projects. The first park bond approved and authorized, 2008 Clean and Safe Neighborhood Parks approved by voters in February 2008 includes \$32.8 million for open space projects on Port property. The first of the Port open space projects funded by the park bond commences in 2009.

The Port has entered into a number of public/private partnerships with developers for the historical preservation, renovation, and redevelopment of certain Port properties. Current information concerning major development projects and opportunities can be found at the Port's website: www.sfport.com. Some of the more significant development project activities and events of 2008 and 2007 include:

Seawall Lot 337 and Pier 48 – In October 2007, the Port Commission authorized a two-step Request for Qualifications/Request for Proposals (RFQ/RFP) process to select a developer for creation of major waterfront public open space and urban mixed use project on Seawall Lot 337 and a complementary use program for Pier 48. Seawall Lot 337 is one of the lots covered by Senate Bill No. 815, allowing for, under specific conditions, the lifting of public trust use restrictions that cover most Port properties. Four development teams responded to the RFQ. In August 2008, the Port consented to the merger of the two remaining teams into a single entity. The newly merged team's RFP response is due in early 2009. If the proposal is accepted, the Port and developer will enter into exclusive negotiations which may result in a Lease Disposition and Development Agreement ("LDDA").

The Exploratorium Museum at Piers 15 – 17 – The Exploratorium, a museum of science, art and human perception, is proposing to lease and rehabilitate portions of Piers 15-17. The Board of Supervisors passed a resolution in June 2005 exempting the potential lease from the competitive bidding process required by Administrative Code Section 2.6-1. The Port Commission approved an ERN with The Exploratorium in February 2006. A City-required fiscal feasibility report was approved by the Board of Supervisors in July 2006. Environmental studies are well underway, and the EIR is expected to be published in 2008 and certified in 2009. In August 2008, the Port Commission approved an amended term sheet for the lease and development of Piers 15 – 17. Since the amendment included major revisions, the amended term sheet will also be submitted to the Board of Supervisors for approval and endorsement.

Rincon Park Restaurants – This completed project is a two-restaurant development at the south end of Rincon Park along the Embarcadero Promenade. Both restaurants opened in January 2008: Waterbar is a seafood restaurant and Epic Roasthouse is a steak house. A piazza in the center joins the two restaurants.

Piers 1½ - 5 – This project entails the rehabilitation of historic bulkhead buildings with ground floor restaurants, upper floor office, public access walkways and guest boat dock. Shell construction was completed in 2007 and subleasing is continuing. Office subleases completed in 2008 include Aperture Group, LLC, Bloomberg and Renaissance Technologies. Several restaurant subleases on the ground floor are currently being finalized. La Mar Cebicheria Peruana, the first restaurant, opened in September 2008.

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The LDDA between the Port and the developer for the Bryant Street Piers Mixed Use and Cruise Terminal Project expired in September 2006, without the developer exercising an option to extend the term of the LDDA. Significant project entitlements remain in place. The project contemplated a mixed use development with a two-berth cruise ship terminal, ground floor retail and restaurant, and upper floor office and entertainment uses on Piers 30-32. A residential condominium tower project (Phase 1), built on a portion of Seawall Lot 330 sold to the developer, was completed in April 2006 and all 136 residential units have been sold. Concept design for the Phase 2 bayfront urban park on The Embarcadero between Piers 30-32 and Pier 38 ("Brannan Street Wharf") was also completed. Under the original development agreement, certain proceeds from the land sale (\$9,000,000) were specifically committed to the construction of a public plaza area called Brannan Street Wharf. The remaining land sale proceeds of \$324,000, together with certain residual receipts from the sale of residential condominium units built on the land sold, were also committed to the project area for the construction of the cruise terminal and the Brannan Street Wharf. Total residual receipts of \$17,584,000 have been distributed to the Port. Engineering design for the Brannan Street Wharf Project is commencing in 2009.

The Port Commission approved assignment of the ERN for a mixed-use recreation project at Piers 27-31 to a new developer in March 2006. The new developer initially endeavored to develop a feasible plan for a mixed use project on Piers 27-31, which included a cruise terminal. In June 2008, the ERN was amended to accommodate the developer's proposal for a revised project, linking the development of office space with associated parking and major public open space at Piers 30-32 with the development of a cruise terminal and open space on Pier 27. The amendment extended the time within which the developer was to complete specific performance benchmarks in connection with the revised proposal. The ERN expired in September 2008, without further action of the Port Commission.

A blue-ribbon advisory panel, formed in 2006 by the Port's Executive Director to assist in a review and update of the Port's cruise terminal project goals and objectives, presented its findings to the Port Commission in September, 2007. Among other things, the panel recommended consideration of Pier 27 for a new terminal. The Port has proceeded with developing conceptual drawings of a cruise terminal on Pier 27 and intends to proceed with planning and predevelopment activities with respect to the cruise terminal on this pier site.

An RFP was issued in Summer 2008 for developing Seawall Lot 351, a two-thirds of an acre site at Embarcadero and Washington Streets. Required uses are retail / restaurant and visitor parking; but developers may propose alternative uses, accompanied by a public trust solution.

Various development and planning activities are also being directed at master planning for the Pier 70 area and at preliminary feasibility analyses for environmental, engineering and economic viability of development in the Piers 90-94 Backlands.

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Long-term obligations. Detailed information concerning the Port's long-term obligations can be found in Note 8 on pages 28 - 31 of this report. As of June 30, 2008, the Port had total long-term obligations of \$11,426,000 including \$4,277,000 that is due during the next fiscal year. Long-term obligations consist of \$8,319,000 in revenue bonds and \$3,107,000 in loans that are secured by specified revenue sources. As discussed in Note 8, the Port issued new refunding revenue bonds in August 2004 to current refund the outstanding Series 1994 Revenue Bonds, taking advantage of lower interest rates and reducing total debt service over the remaining five years of the issue (through July 1, 2009). No other debt has been issued.

Economic and Other Factors

Economy. Uncertainties concerning the national, state and local economic condition impact the Port. The national focus on homeland security from acts of terrorism initially reduced tourist travel and tourist-dependent revenues in the City. Among other things, favorable currency exchange against the US dollar has increased international tourist travel to San Francisco in recent years. The Port's restaurant and retail tenants have recovered and generally report steadily increasing sales activity. Commercial office vacancies and large sublease opportunities are increasing in 2008, giving rise to negative absorption in the central business district. In direct contrast, the Port has been able to maintain and increase its monthly rent roll. Recurring monthly base rents are approximately \$3.7 million at June 30, 2008 (compared to \$3.4 million at June 30, 2007). Note 9 (page 32 - 33) contains required financial statement disclosure information covering the future rental income stream from minimum rents over the noncancellable term of active operating leases. The Port anticipates that it will be able to maintain revenues at current levels with minimum year-to-year growth. Revenue loss to the Port during down periods has been generally limited to some decline in overage rents (percentage rents above the minimum) and some increase in delinquencies. The current global financial crises weakening foreign currency presents some new challenges for 2009.

While the revenue side shows strength, the broader economic climate retains a great deal of uncertainty and challenges on the cost side: unstable fuel costs, fluctuating cost of construction materials, supply chain disruptions due to natural or man-made disasters, etc. These general economic conditions are taken into consideration when preparing budgets and forecasts.

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San Francisco Waterfront Special Area Plan. In July 2000, the Port agreed to amend its Waterfront Land Use Plan, and the San Francisco Bay Conservation and Development Commission (BCDC) its San Francisco Bay Plan to create consistent plans for the waterfront area between the Hyde Street Pier and China Basin (San Francisco Waterfront Special Area Plan). Among other things, the Special Area Plan commits the Port to expend up to \$30 million over a 20-year period for the removal of certain piers and the construction of major public plazas and other public access improvements. The Port is permitted to seek and use other funding sources (i.e. grants and contributions) to finance the required pier removals and public access improvements. Until sufficient funding from other sources is secured, the Port may need to commit significant capital funds in future years for Special Area Plan projects. As of June 30, 2008, \$16.7 million has been appropriated and \$1.6 million has been expended for projects under the agreement. Assembly Bill No. 1389, signed by former Governor Gray Davis in October 2001 to authorize approval of the development plans for a cruise ship terminal at Piers 30-32, also ratified the San Francisco Waterfront Special Area Plan adopted by the Port and BCDC.

Port security. The Port participates in a regional Port Security Committee, which reviews security issues and needs affecting ports and terminals in the San Francisco Bay Area. Since 2005, the Port has had a full-time homeland security manager responsible for developing, directing, overseeing and implementing a comprehensive security program mandated by the federal government. As a department of the City and as a California port, the Port of San Francisco has been allocated funds under the Port Security Grants Program, managed by the Transportation Security Administration, and other Department of Homeland Security programs to plan for and to implement effective response to emergent threats to Port and City property.

Requests for Information

This report is designed to provide a general overview of the Port of San Francisco's finances. The financial statements and related informative disclosures in the notes to the financial statements and required supplementary information is presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Public Information Officer at Port of San Francisco, Pier 1, San Francisco, California, 94111.

Questions concerning the City and County of San Francisco or requests for a copy of the City's Comprehensive Annual Financial Report should be addressed to: Office of the Controller, City and County of San Francisco, at City Hall, Room 316, 1 Dr. Carlton B. Goodlett Place, San Francisco, California 94102.

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**Balance Sheet
(in thousands)**

<i>June 30,</i>	2008	2007
Assets		
Current Assets:		
Cash and investments, held in City Treasury - Port operating fund	\$ 81,498	\$ 80,688
Cash outside of City Treasury	5	5
Receivables - net	5,266	6,510
Materials and supplies	1,034	1,245
Prepaid insurance and other assets	75	37
Total current assets	87,878	88,485
Restricted Assets:		
Cash held in City Treasury:		
Lessee and other deposits	6,060	5,638
Capital outlay	132	151
Bond interest and redemption held by trustee	7,121	6,550
Other - Lessee deposits	660	790
Total restricted assets	13,973	13,129
Capital Assets - net	275,058	272,362
Other Assets	3,354	4,283
Total assets	\$ 380,263	\$ 378,259
Liabilities		
Current Liabilities Payable from Current Assets:		
Accounts payable and accrued liabilities	\$ 10,557	\$ 10,543
Current maturities of long-term obligations	92	88
Accrued interest payable	128	132
Total current liabilities	10,777	10,763
Current Liabilities Payable from Restricted Assets:		
Current maturities of revenue bonds	4,185	4,070
Accrued bond interest payable	147	202
Lessee and other deposits	6,720	6,428
Total payable from restricted assets	11,052	10,700
Noncurrent Liabilities	8,997	3,624
Deferred Revenue - Net of current portion	11,601	12,234
Long-term Obligations - Net of current maturities	7,149	11,240
Total liabilities	49,576	48,561
Net Assets:		
Invested in capital assets, net of related debt	269,936	262,937
Restricted	617	154
Unrestricted	60,134	66,607
Total net assets	330,687	329,698
Total liabilities and net assets	\$ 380,263	\$ 378,259

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**Statement of Revenues, Expenses and Changes in Net Assets
(in thousands)**

<i>Years Ended June 30,</i>	2008	2007
Operating Revenues:		
Commercial and industrial	\$ 40,149	\$ 36,496
Parking	10,891	10,514
Cargo	4,383	4,152
Fishing	1,854	1,760
Ship repair	884	1,332
Harbor services	901	887
Cruise	1,296	1,763
Other maritime	1,717	1,391
Other	2,423	2,898
Total operating revenues	64,498	61,193
Operating Expenses:		
Operations and maintenance	56,406	50,887
Depreciation and amortization	10,407	10,253
Total operating expenses	66,813	61,140
Operating income (loss)	(2,315)	53
Other Income (Expense):		
Interest and investment income	3,613	4,223
Interest expense	(682)	(797)
Gain (loss) from disposition of assets	(3,767)	(1,158)
Total nonoperating revenues and expenses	(836)	2,268
Capital Contributions - Capital grants and other contributions	3,942	2,224
Special Items	198	17,386
Change in Net Assets	989	21,931
Net Assets - beginning of the year	329,698	307,767
Net Assets - end of the year	\$ 330,687	\$ 329,698

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**Statement of Cash Flows
(in thousands)**

<i>Years Ended June 30,</i>	2008	2007
Cash Flows from Operating Activities:		
Cash received from tenants for rent	\$ 55,247	\$ 51,481
Cash received from customers and others	7,757	7,457
Deposits received from tenants and customers	1,626	1,619
Cash paid to employees for services	(25,200)	(24,085)
Cash paid to suppliers for goods and services	(14,172)	(13,204)
Cash paid for quasi-external transactions	(11,035)	(11,114)
Customer deposits returned	(1,274)	(160)
Net cash provided by operating activities	12,949	11,994
Cash Flows from Noncapital Financing Activities -		
Net cash provided by noncapital financing activities		
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment	(14,005)	(12,877)
Dredging	(1,088)	(245)
Payments of long-term debt	(4,158)	(4,059)
Interest payments on long-term debt	(492)	(600)
Residual receipts received from a development project	198	17,386
Capital grants received	4,034	2,079
Proceeds from sale of equipment and materials	1	70
Pier demolition and other asset disposition costs	(35)	(1,228)
Net cash (used) provided by capital and related financing activities	(15,545)	526
Cash Flows from Investing Activities -		
Interest income received	4,634	3,448
Net cash provided by investing activities	4,634	3,448
Net Increase in Cash and Cash Equivalents	2,038	15,968
Cash and Cash Equivalents - Beginning of year	91,145	75,177
Cash and Cash Equivalents - End of year	\$ 93,183	\$ 91,145

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**Statement of Cash Flows (In Thousands)
(Continued)**

<i>Years Ended June 30,</i>	2008	2007
Noncash Capital and Related Financing Activities:		
Acquisition and construction of property, plant and equipment included in accounts payable and accrued liabilities	\$ 951	\$ 920
Loss on abandonment of property and equipment	3,733	
Tenant improvements financed by rent credit		589
Noncash Investing Activities:		
Change in fair value of cash and investments held in City Treasury	\$ 316	\$ 10
Change in fair value of U.S. Treasury Note held by bond trustee	62	28
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income (loss)	\$ (2,315)	\$ 53
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	10,407	10,253
Change in allowance for doubtful accounts	(1,111)	142
Net change in deferred revenue	(1,246)	(233)
Changes in assets and liabilities:		
(Increase) decrease in:		
Receivables	1,496	(773)
Materials and supplies	211	(93)
Prepaid insurance and other assets	1,916	2,098
Increase (decrease) in:		
Accounts payable and accrued liabilities	3,169	(1,010)
Lessee deposits	422	1,557
Net cash provided by operating activities	\$ 12,949	\$ 11,994
Reconciliation of Cash and Cash Equivalents to the Balance Sheet:		
Cash and investments held in City Treasury - Port operating fund	\$ 81,498	\$ 80,688
Cash deposit outside of City Treasury	5	5
Cash held in City Treasury:		
Lessee deposits	6,060	5,638
Capital outlay	132	151
Cash held by Trustee - Bond interest and redemption (see Note 2)	5,126	4,617
	92,821	91,099
Fair value adjustment, cash and investments held in City Treasury	362	46
Cash and Cash Equivalents	\$ 93,183	\$ 91,145

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Notes to Financial Statements

Note 1 - Significant Accounting Policies:

a. Basis of Presentation

The Port of San Francisco (Port) is an enterprise fund of the City and County of San Francisco (City). Only the accounts of the Port are included in these financial statements. There are no component units that should be considered for inclusion in the Port's financial reporting entity.

A five-member Port Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for fixed terms of four years. The Port is an integral part of the City, and the accompanying financial statements are included in the City's Comprehensive Annual Financial Report.

Prior to February 1969, the Port was owned by the State of California ("State") and administered by the San Francisco Port Authority, a State agency. In February 1969, the State transferred the Port in trust to the City under the terms and conditions specified in the State statutes of 1968, Chapter 1333 ("Burton Act"), as amended, and ratified by the City's voters in November 1968.

Under the terms of the Burton Act, the State Legislature reserved the right to amend, modify, or revoke, in whole or in part, the transfer of lands in trust, provided that the State would then assume all lawful obligations related to such lands.

The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Substantially all of the Port's property rental customers are located within the boundaries of the City. Port revenues are held in a separate fund ("Harbor Fund") and are appropriated for expenditure pursuant to the budget and fiscal provisions of the City Charter, consistent with trust requirements. Under public trust doctrine, the Burton Act, and the transfer agreement between the City and the State, these revenues may be spent only for uses and purposes of the public trust.

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Notes to Financial Statements

The Port's financial statements are prepared using the economic resources measurement focus and the accrual basis in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the Port applies all applicable Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred.

In accordance with GASB Statement No. 34 (GASB 34) "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments," the balance sheet presents the difference between assets and liabilities as net assets. Net assets are reported in three broad components, as applicable – invested in capital assets, net of related debt; restricted; and unrestricted. Under the all-inclusive approach to presenting the changes in net assets, all Port revenues, including capital contributions, are reported in the statement of revenues, expenses and changes in net assets.

b. Cash and Investments

The Port reports its investments at fair value based upon quoted market prices. Fair value is defined as the amount that the Port could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Short term investments are reported at cost (or amortized cost), which approximates fair value. For purposes of the statement of cash flows, all unrestricted and restricted cash and highly liquid investments with maturities of three months or less, when purchased, are considered to be cash equivalents. In addition, the Port considers its deposits with the City Treasurer (see Note 2) to be demand deposits and therefore cash for the purposes of the statement of cash flows.

c. Materials and Supplies

Materials and supplies are used for construction and maintenance of Port facilities and are stated at average cost.

d. Restricted Assets

Cash security deposits received by the Port pursuant to lease agreements are held in the City Treasury. Other lessee deposits are renewable certificates of deposit tendered by tenants in lieu of cash and held by banks as third-party certificates in the name of the Port. Other lessee deposits also include deposits receivable pursuant to adjustment provisions in the leases.

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Notes to Financial Statements

Bond interest and redemption represent funds accumulated for debt service payments due in the next twelve months and reserve funds set aside to make up potential future deficiencies. A bond trustee holds these funds.

Capital outlay funds are restricted for use in construction and acquisition of equipment, due to restrictions from federal and state grant agreements and bond resolutions.

e. Capital Assets

Land transferred to the City in February 1969 is stated at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State in prior years to reflect appraised values in 1929.

Other capital assets are carried at cost or at fair market value at the date received in the case of property received by donation or by termination of a lease. Donated surplus equipment received from the federal government is carried at an estimated value determined in accordance with federal guidelines. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets. Land improvements (principally pavement and pier promenades) with a cost of approximately \$21 million are not depreciated because, in the opinion of management, the assets will be maintained to provide indefinite useful lives. Building (tenant) improvements are amortized using the straight-line method over the shorter of the estimated life of the asset or the remaining term of the related lease. Maintenance and repairs are expensed as incurred.

Interest paid on bond funds used for construction purposes, less interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, if applicable, is capitalized from the date of borrowing through the construction period.

f. Other Assets

Bond issue costs are amortized using the straight-line method over the life of the bond. Original bond issue premiums are offset against the related debt and amortized using the straight-line method over the life of the bonds.

Dredging costs are amortized using the straight-line method over the estimated useful period ranging from one to seven years.

Waterfront Land Use Plan (Plan) costs are amortized using the straight-line method over an estimated life of 20 years. The Plan was approved by the City Board of Supervisors in September 1997.

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g. Deferred Revenue

Deferred revenue consists primarily of rent credits issued to customers. Deferred revenue is recognized in accordance with the lease agreements and is amortized using the straight-line method over the term of the specific leases.

h. Refunding Debt

The Port's 1994 revenue refunding bonds were current refunded in August 2004 (see Note 8). The difference between the reacquisition price and the net carrying amount of the old debt is deferred and together with the unamortized difference from the 1994 refunding is reported as a reduction of the bonds payable. The total deferred amount is being amortized on a straight-line basis over the remaining life of the bonds through July 1, 2009.

i. Operating Revenues and Expenses

The Port distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from the real estate, maritime and other principal ongoing activities of the Port's normal business operations. Real estate revenues consist principally of rentals of Port property to industrial, commercial, retail, office and other business enterprises. Maritime revenues are derived from vessel operations, warehousing, ship repair, harbor services and other maritime activities. Vessel operations include dry, liquid bulk, and break bulk cargoes, cruise, and other berthing. Other operating revenues include building permit and inspections fees. Operating expenses include facility maintenance, the cost of operations, administrative expenses and depreciation and amortization on capital assets. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Minimum base rental revenue is normally recognized on the straight-line basis over related lease terms. Most term leases provide that rents be payable to the Port in equal monthly installments on the first day of each month until terminated. Contingent rentals are recorded or accrued only for periods in which the contingent thresholds for gross sales or revenues are met. Use fees are recorded when the Port fee is determined based on actual occupancy or use. Fees are assessed by a measured unit (e.g. lineal feet of vessel for dockage) and/or measured time (e.g. per twenty-four hour day). Maritime activity or use fees may be based on a standardized tariff schedule or covered by specific contractual agreements.

Grants and similar revenue items are recognized as revenue as soon as all eligibility requirements have been met.

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j. Capital Contributions

The Port, at various times, receives federal and state grants and other funds from external sources for construction of waterfront facilities. The funds are reported as capital contributions on the Statement of Revenues, Expenses and Changes in Net Assets.

k. Special Items

Significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence are reported separately as special items on the Statement of Revenues, Expenses and Changes in Net Assets

l. Environmental Expenses

The Port incurs costs associated with environmental clean-up which arise during the normal course of business. These costs are recorded as a liability when the Port is required to perform the clean-up. Environmental liabilities are accrued when it is probable that obligations have been incurred and the associated amounts can be reasonably estimated.

m. Effects of New Pronouncement

In 2008, the City and Port adopted the provisions of GASB Statement No. 45 (GASB 45) "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions," GASB 45 establishes standards for how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. The statement generally requires accounting for and reporting the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as pension benefits. Annual OPEB cost for most employers is to be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The statement does not require governments to fund their OPEB plans. As allowed by GASB 45, these provisions are being applied prospectively: the OPEB liability is established as zero as of the beginning of the initial year of implementation (2008) with the unfunded actuarial liability amortized over future periods. The City has adopted the maximum acceptable amortization period of thirty years.

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n. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2 - Cash and Investments:

The Port maintains its operating fund cash and investments and a portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The Comprehensive Annual Financial Report of the City provides more detailed information concerning deposit and investment risks associated with the City's pool of cash and investments at June 30, 2008.

The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer, subject to review by the Treasury Oversight Committee. The Treasury Oversight Committee, established under California Government Code Sections 27130 to 27137, is composed of various City officials and representatives of agencies with large cash balances. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The provisions of the City's investment policy also address interest rate risk, credit risk, custodial credit risk and concentration of credit risk and provides for additional restrictions related to investments. Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City Treasurer manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

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Credit risk is that risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The City's pool is not registered with the SEC as an investment company and is not rated. Custodial credit risk for investments is that risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments; however, it is the practice of the City Treasurer that all investments are insured, registered or held by the Treasurer's custodial agent in the City's name. To address concentration of credit risk, the policy specifies authorized investment types and sets parameters for maximum maturity, maximum percentage of the total portfolio which may be invested in specific investment types, and maximum investment to one issuer for certain investment types. U.S. Treasury and Agency securities are not subject to this limitation.

Custodial credit risk for deposits is that risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging authorized securities as collateral. The fair value of pledged securities must equal at least 110 percent of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2008, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

The following table shows the percentage distribution of the City's pooled investments by maturity:

Investment maturities (in months)			
Under 1	1 – 6	6 – 12	12 – 36
6.9%	52.7%	11.6%	28.8%

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The Port's cash and investments, reported at fair value, at June 30, 2008 and 2007 are as follows:

	2008	2007
	(in thousands)	
Cash and investments in City Treasury	\$ 81,498	\$ 80,688
Cash outside of City Treasury	5	5
Restricted assets:		
Cash and investments in City Treasury	6,192	5,789
Deposits and investments outside City Treasury:		
Cash and investments held by bond trustee	7,121	6,550
Lessee deposits	629	621
	<u>\$ 95,445</u>	<u>\$ 93,653</u>

Lessee security deposits are held on behalf of the Port by third party trustees and invested in renewable certificates of deposit. These deposits, made by tenants and customers directly to banks, are held outside of the City Treasury and are not collateralized as public agency deposits. One uncollateralized account for \$167,000 at June 30, 2008 and 2007 exceeds the federal insurance limit.

At June 30, 2008 and 2007, cash and investments held in reserve and for debt service payments by trustee consist of:

	2008	2007
	(in thousands)	
Reserve Fund:		
U.S. Treasury Money Market Fund	\$ 181	\$ 213
U.S. Treasury Note, due June 15, 2009	1,995	1,933
Debt Service Funds -		
U.S. Treasury Money Market Fund	4,945	4,404
	<u>\$ 7,121</u>	<u>\$ 6,550</u>

Investment of all funds and accounts held by the bond trustee are governed by the Bond Indenture rather than the general provisions of the California Government Code or the City's investment policy. Investments held by the bond trustee consist of a single U.S. Treasury note maturing in June 2009 in the Reserve Fund and shares of a registered money market fund. Although other investment types are permitted by the Indenture, their use is not anticipated. The money market fund has a Standard & Poor's rating of AAAm.

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Note 3 - Receivables:

At June 30, 2008 and 2007, receivables consisted of:

	2008	2007
	(in thousands)	
Trade accounts receivable	\$ 3,680	\$ 4,736
Less allowance for doubtful accounts	(889)	(2,000)
	2,791	2,736
Grants receivable	1,451	1,571
Accrued interest receivable	436	1,203
City General Fund, Cosco Busan settlement proceeds	226	
Other	362	1,000
	\$ 5,266	\$ 6,510

Note 4 - Capital Assets:

At June 30, 2008 and 2007, capital assets consisted of:

	2008	2007	Estimated Useful Life (Years)
	(in thousands)		
Land and land improvements	\$ 121,509	\$ 121,045	
Buildings, structures and related improvements	307,733	295,610	5 - 64
Furniture, machinery and equipment	16,548	14,915	2 - 20
Total	445,790	431,570	
Less accumulated depreciation	(203,441)	(193,170)	
	242,349	238,400	
Construction work in progress	32,709	33,962	
Total	\$ 275,058	\$ 272,362	

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Total interest cost was \$433,000 and \$547,000 for fiscal years 2008 and 2007. Total interest earned was \$3,494,000 and \$4,212,000 for fiscal years 2008 and 2007. No interest cost and earnings were capitalized in 2008 and 2007.

The buildings, structures and improvements identified above include pier substructures, which have an estimated useful life greater than 50 years. Such long-lived assets total \$21,915,000 as of June 30, 2008 and 2007.

The cost of fully depreciated assets still in use was approximately \$107,293,000 at June 30, 2008, including \$100,421,000 in buildings, structures and improvements and \$ 6,872,000 in furniture, machinery and equipment.

The following is a summary of changes in capital assets for the year ended June 30, 2008 (in thousands):

	Balance June 30, 2007	Increases	Decreases	Balance June 30, 2008
Land and land improvements	\$ 121,045	\$ 464	\$	\$ 121,509
Buildings, structures and related improvements	295,610	12,123		307,733
Furniture, machinery and equipment	14,915	1,770	137	16,548
Total	431,570	14,357	137	445,790
Construction work in progress	33,962	14,078	15,331	32,709
	465,532	28,435	15,468	478,499
Less accumulated depreciation for:				
Buildings, structures and related improvements	183,139	9,275		192,414
Furniture, machinery and equipment	10,031	1,133	137	11,027
Total accumulated depreciation	193,170	10,408	137	203,441
Total	\$ 272,362	\$ 18,027	\$ 15,331	\$ 275,058

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Note 5 - Other Assets:

Other assets at June 30, 2008 and 2007, net of related amortization, consisted of:

	2008	2007
	(in thousands)	
Deferred debt	\$ 63	\$ 126
Dredging costs	1,004	1,882
Waterfront land use plan	1,525	1,690
Noncurrent tenant accounts receivable	649	464
Other deferred costs	113	121
	<u>\$ 3,354</u>	<u>\$ 4,283</u>

Noncurrent tenant accounts receivable represent the long-term portion of lease or other agreement obligations from tenants that will be collected in future years, including an installment payment agreement with a City department. In connection with a former subtenant and operator of a municipal tow yard on Port property, the Port and the City department agreed to a five-year monthly payment plan for certain rents still due to the Port upon termination of the towing contract by the City in 2005. The Port Commission approved the installment payment plan for total outstanding rents of \$193,191 plus interest at 2% per annum.

Note 6 - Accounts Payable and Accrued Liabilities:

At June 30, 2008 and 2007, accounts payable and accrued liabilities consisted of:

	2008	2007
	(in thousands)	
Accounts payable	\$ 2,391	\$ 2,815
Current portion of deferred revenue	1,140	1,753
Accrued liabilities	4,698	3,830
Accrued payroll, compensated absences and related costs	2,328	2,145
	<u>\$ 10,557</u>	<u>\$ 10,543</u>

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Note 7 - Noncurrent Liabilities:

At June 30, 2008 and 2007, noncurrent liabilities consisted of:

	2008	2007
	(in thousands)	
Postemployment benefits other than pensions	\$ 2,805	
Estimated costs of drydock disposal	2,800	
Workers' compensation	2,150	\$ 2,269
Compensated absences and related costs	859	855
Litigation, claims and judgments	300	500
Payable to SFPUC	83	
	<u>\$ 8,997</u>	<u>\$ 3,624</u>

Note 8 - Long-Term Obligations:

Long-term obligations at June 30, 2008 and 2007 consisted of the following:

	Interest Rate (%)	Last Series Matures	Balance 2008 (in thousands)	2007
Revenue bonds	2.25 - 4.00	July 1, 2009	\$ 8,319	\$ 12,203
Loan payable	4.50	August 1, 2028	3,107	3,195
Total long-term obligations			11,426	15,398
Less current maturities			(4,277)	(4,158)
Net long-term obligations			<u>\$ 7,149</u>	<u>\$ 11,240</u>

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The following is a summary of changes in long-term obligations for the years ended June 30, 2008 and 2007 (in thousands):

	Revenue Bonds	Loan	Total
Balances as of June 30, 2006	\$ 15,991	\$ 3,279	\$ 19,270
Current maturities, retirements and other decreases, net	(3,788)	(84)	(3,872)
Balances as of June 30, 2007	12,203	3,195	15,398
Current maturities, retirements and other decreases, net	(3,884)	(88)	(3,972)
Balances as of June 30, 2008	\$ 8,319	\$ 3,107	\$ 11,426

The annual payments required for all outstanding long-term obligations are as follows (in thousands):

	Revenue Bonds		Other Long Term Obligations		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
<u>Year Ending June 30:</u>						
2009	\$ 4,185	\$ 222	\$ 92	\$ 140	\$ 4,277	\$ 362
2010	4,320	75	96	136	4,416	211
2011			100	131	100	131
2012			105	127	105	127
2013			110	122	110	122
2014 – 2018			627	532	627	532
2019 – 2023			781	377	781	377
2024 – 2028			974	185	974	185
2029			222	10	222	10
<u>Total</u>	<u>\$ 8,505</u>	<u>\$ 297</u>	<u>\$ 3,107</u>	<u>\$ 1,760</u>	<u>\$ 11,612</u>	<u>\$ 2,057</u>

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Bonds

Bond obligations at June 30, 2008 and 2007 consisted of the following:

	Interest Rate (%)	Last Series Matures	Balance	
			2008 (in thousands)	2007
Revenue Bonds -				
Series 2004	2.25 - 4.00	July 1, 2009	\$ 8,505	\$ 12,575
Less:				
Current maturities			(4,185)	(4,070)
Unamortized bond premium			76	152
Deferred amount on refunding			(262)	(524)
Net Bond Obligations			\$ 4,134	\$ 8,133

In August 2004, the Port issued \$19,940,000 in Revenue Refunding Bonds, Series 2004 with an average interest rate of 3.16% to current refund \$23,175,000 of outstanding Series 1994 Revenue Bonds with an average coupon rate of 5.84%. Net proceeds from the new bonds plus an additional \$3.9 million of Series 1994 debt service monies were used to defease the 1994 bonds. The Port completed the current refunding to reduce its total debt service payments over the subsequent five years by \$1.6 million and to obtain an economic gain (difference between the present value of the old and new debt service payments) of \$1.2 million. The 1994 bonds refunded \$49,975,000 of outstanding 1984 Revenue Bonds, Series A, B and C with an average interest rate of 8.4 percent.

The refunding resulted in a difference between the reacquisition price (principal of the old debt plus 2% call premium) and the net carrying amount of the old debt of \$0.5 million. The previous 1994 refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$2.36 million. The total difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through July 1, 2009 using the straight line method.

The revenue bonds are secured by a pledge of Net Revenues of the Port, as defined by the Revenue Bond Indenture. Under the terms of the Indenture, as amended, the Port is required to deposit with a trustee in a reserve fund, an amount equal to the lesser of (a) maximum debt service accruing in any year during the life of such bonds, (b) ten percent (10%) of the proceeds derived from the sale of Series 2004 Bonds, or (c) 1.25 times the average annual debt service due with respect to Series 2004 Bonds. At June 30, 2008, the Port was in compliance with this bond indenture requirement.

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While Series 2004 Bonds are outstanding, the Port may not create liens on its property essential to operations, dispose of any property essential to maintaining revenues or operating the Port, and must maintain specified insurance. The Port may issue additional bonds under the Indenture provided the Port complies with the Additional Bonds Test, as defined in the Indenture.

Covenants of the Indenture, as amended, include that the Port will maintain its business operations, and establish and maintain rentals, rates, fees, and charges for the use of Port property and for services rendered by the Port so that the Net Revenue, as defined in the bond indenture, in each fiscal year will be at least equal to 130% of aggregate annual debt service for such fiscal year. At June 30, 2008, the Port was in compliance with such bond covenants.

The Series 2004 Revenue Bonds are subject to an arbitrage rebate requirement. The requirements stipulate, in general, that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The cumulative arbitrage liability as of June 30, 2008 was approximately \$164,000.

Loan

The Port has entered into a loan agreement with the California Department of Boating and Waterways (Cal Boating) for \$3.5 million to finance certain Hyde Street Harbor improvements. The loan is subordinate to all bonds payable by the Port. Interest accrues at a rate of 4.5% per annum on the unpaid balance commencing with the first draw on the loan. The term is 30 years from the date of the first draw, which occurred in April 1998. The loan is secured by Gross Revenues as defined in the loan agreement. The project was completed as scheduled in 2002 and annual payments commenced on August 1, 2002.

	2008	2007
	(in thousands)	
Loan payable to Cal Boating	\$ 3,107	\$ 3,195
Less current portion	(92)	(88)
Net loan payable	\$ 3,015	\$ 3,107

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Note 9 - Operating Revenues - Property Rentals:

Certain property rental agreements specify rental payments based on a percentage of tenant sales, subject to a minimum amount. Property rental revenues were comprised as follows:

	2008	2007
	(in thousands)	
Minimum rentals	\$ 44,808	\$ 41,497
Percentage rentals	11,733	10,836
	<u>\$ 56,541</u>	<u>\$ 52,333</u>

Minimum future rental income under noncancellable operating leases having terms in excess of one year are as follows:

<u>Year Ending June 30</u>	(in thousands)
2009	\$ 28,467
2010	24,863
2011	21,141
2012	19,733
2013	18,237
2014 - 2018	78,951
2019 - 2023	67,381
2024 - 2028	52,431
2029 - 2033	48,296
2034 - 2038	42,623
2039 - 2043	28,985
2044 - 2048	22,165
2049 - 2053	13,496
2054 - 2058	9,698
2059 - 2063	9,170
2064 - 2068	6,846
2069 - 2073	1,537
2074	307
<u>Total</u>	<u>\$ 494,327</u>

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The approximate cost of property subject to operating leases and property held for lease at June 30, 2008 consisted of:

	(in thousands)
Land and land improvements	\$ 52,473
Buildings, structures, and related improvements at cost, less accumulated depreciation of \$165,745	72,303
Total	\$ 124,776

Note 10 - Employee Benefit Plans:

a. Retirement Plans

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Plan Description - The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Port along with other employees of the City. The Plan provides basic service retirement, disability and death benefits based on specified percentages of defined final average salary and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, California 94102 or by calling (415) 487-7020.

Funding Policy - Contributions are made to the basic plan by both the Port and its employees. Employee contributions are mandatory. Employee contribution rates for 2008, 2007 and 2006 varied from 7.0% to 8.0% as a percentage of covered payroll. The Port is required to contribute at an actuarially determined rate which was 5.91% for June, 30, 2008, 6.24% for June 30, 2007, and 6.58% for the year ended June 30, 2006. The Port's employer contributions amounted to \$1,113,000, \$1,133,000, and \$1,056,000 for 2008, 2007, and 2006, respectively. The Port's contributions to the Retirement System on behalf of its employees amounted to \$151,000, \$148,000, and \$199,000, for the years ended June 30, 2008, 2007, and 2006, respectively. Since 2005, substantially all required employee contributions were paid to the Retirement System by such affected employees.

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For those groups of employees not mandated by collective bargaining agreements to contribute to the Retirement System, the Port's contributions remained at 7.0% to 8.0% of covered payroll.

State of California

Plan Description - Certain employees who commenced their employment at the Port prior to February 1969 were eligible to participate in California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan that acts as a common investment and administrative agent for participating public entities within the state of California. There are no active Port employee participants in PERS.

Effective with the PERS June 30, 2003 actuarial valuation, PERS mandated that the City's miscellaneous members plan be included in a cost-sharing multiple-employer plan consisting of various government entities with plan memberships of less than 199 active members. A separate report for the City's plan within PERS is not available. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

Funding Policy - There were no contributions required in 2008, 2007, or 2006. Participating employees were required to contribute 7 percent of their salary to PERS and the City and Port were required to contribute at an actuarially determined rate.

The City's Comprehensive Annual Financial Report contains disclosures and Required Supplementary Information (RSI) for all covered City employees. Amounts for the Port are not separable from the City totals in those disclosures.

b. Deferred Compensation Plan

The City offers its employees a deferred compensation plan (Plan) created in accordance with Internal Revenue Code (IRC) Section 457. The Plan, available to all Port employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

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In accordance with GASB Statement No. 32, "Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans", Plan assets and related liabilities to Plan participants are not included in the City's financial statements. The City has no fiduciary accountability for the Plan. It has no administrative involvement and does not perform the investing function.

The amounts deferred by Port employees totaled \$1,261,000, \$1,217,000 and \$1,166,000 for 2008, 2007 and 2006, respectively.

c. Health Care Benefits

Health care benefits of Port employees, retired employees and surviving spouses are financed by beneficiaries and by the City principally through the City and County of San Francisco Health Service System. The annual contribution to the city health plan is determined by Charter provision based on similar contributions made by the ten most populous counties in California. The Health Service System issues a publicly available financial report that includes financial statements and supplementary information for the health care benefits. That report may be obtained by writing to the San Francisco Health Service System, (the City Health Service System). The Port's payments for all health care benefits amounted to approximately \$3,529,000, \$3,252,000 and \$2,941,000 in fiscal years 2008, 2007 and 2006, respectively. Included in these amounts are approximately \$892,000, \$789,000 and \$760,000 for 2008, 2007 and 2006, respectively, to provide postretirement benefits for retired employees in the City Health Service System, on a pay-as-you-go basis.

The City has determined a City-wide Annual Required Contribution (ARC) and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The City has allocated \$3,697,000 of the City-wide ARC and OPEB cost to the Port for the year ended June 30, 2008 based upon its percentage of City-wide payroll costs. The difference between the allocation and the amount paid of \$2,805,000 has been recorded as a net OPEB obligation by the Port as of June 30, 2008.

The City issues a publicly available financial report that includes the complete note disclosures and RSI related to the City's postretirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, California 94102, or by calling (415) 554-7500.

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As noted above in Note 10a, certain employees who commenced their employment at the Port prior to February 1969 were eligible to participate in PERS. Since 2003, PERS has included the City's miscellaneous members plan in a cost-sharing multiple-employer plan consisting of various government entities with plan memberships of less than 199 active members. A separate report for the City's plan (including Port members) within PERS is not available. Benefit provisions and all other requirements are established by state statute and city ordinance. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

The Port's contribution for health care benefits, which amounted to approximately \$3,529,000, \$3,252,000 and \$2,941,000 in fiscal years 2008, 2007 and 2006, respectively, is determined by Charter provision based on similar contributions made by the ten most populous counties in California. Included in these amounts are approximately \$1,305,000, \$1,235,000 and \$1,013,000 for 2008, 2007 and 2006, respectively, to provide postretirement healthcare benefits for retired employees. The Port's liability for both current employee and post retirement health care benefits is limited to its annual contribution. The Port's contribution is paid out of current available resources and funded on a pay-as-you-go basis. Under new accounting and reporting requirements defined by GASB No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions", the City and the Port are required to begin reporting the liability and disclosing related information for unfunded post retirement medical benefits in the Port's financial statements for the fiscal year ended June 30, 2008.

d. Wellness Incentive Program

The City established in fiscal year 2003, on a pilot basis, a Wellness Incentive Program (the Program) to promote workforce attendance. Under the Program, any full-time employee leaving employment of the City upon service or disability retirement may receive payment for a portion of accrued sick leave credits at the time of separation. The amount of this payment is based on two and one-half percent of accrued sick leave credits at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, are not included in this computation. Under amended collective bargaining agreements that originally became effective July 1, 2006, the Program continues through June 30, 2011. The estimated future payments under the Program are included in the accrued liabilities disclosed in Notes 6 and 7.

**Port Commission
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Notes to Financial Statements

Note 11 - Related Party Transactions:

The Port receives services from, and provides services to, various City departments. The cost of services received, included as operating expenses in the financial statements, was approximately \$11,035,000 in 2008 and \$11,114,000 in 2007. Rents from City departments included in operating revenues were approximately \$4,577,000 and \$3,853,000 in 2008 and 2007, respectively. Receivables relating to such transactions are disclosed in Notes 3 and 5.

The Port continues to evaluate its payments to the General Fund and various City departments for services that support uses and activities within the Port area and work with the City to refine the methodologies used for the allocation of City direct and indirect costs and expenses.

Under a memorandum of understanding with the San Francisco Public Utilities Commission (SFPUC), SFPUC is advancing funds to provide for the design and construction of certain energy efficiency projects at identified Port facilities. The Port is committed to repay such advances over a four year period commencing in fiscal year 2009-10, with interest at 3.5% per annum. The amount advanced through June 30, 2008 is with the liabilities disclosed in Note 7.

Note 12 - Special Items

In connection with the original Piers 30-32 mixed-use cruise terminal development project, and as approved by state legislation in 2001 (Assembly Bill No. 1389), a portion of Seawall Lot No. 330 was sold to the developer. The first phase of the development project, a residential condominium tower on the land sold, was completed in 2006. Certain residual receipts from the sale of residential condominium units accrue to the Port. All of the condominium units have been sold and the Port received its share of residual proceeds of \$198,000 in 2008 and \$17,386,000 in 2007.

**Port Commission
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Notes to Financial Statements

Note 13 - Commitments, Litigation and Contingencies:

a. Commitments

The Port is presently planning various development projects which involve a commitment to expend significant funds. Under an agreement with The San Francisco Bay Conservation and Development Commission finalized in 2001 (The San Francisco Waterfront Special Area Plan), the Port is committed to fund and expend up to \$30 million over a 20-year period for pier removal, parks and plazas and other public access improvements. As of June 30, 2008, \$16.7 million has been appropriated and \$1.6 million has been expended for projects under the agreement. The \$16.7 million in approved appropriations include \$9.0 million received from the sale of a portion of Seawall Lot 330 to the developer. After expiration of the original development agreement in 2006, the land sale proceeds of \$9.0 million remain designated for the design and construction of a public plaza required by the Special Area Plan.

The Port had firm purchase and contract commitments at June 30, 2008 for approximately \$5.4 million for capital projects and \$2.4 million for general operations.

The Port has a noncancellable operating lease (sublease) for its offices at Pier 1 which requires the following minimum annual payments (in thousands):

2009	\$ 3,214
2010	3,214
2011	3,214
2012	3,214
2013	3,214
2014 - 2018	15,685
2019 - 2023	15,273
2024 - 2028	15,273
2029 - 2033	15,274
2034 - 2038	15,273
2039 - 2043	15,273
2044 - 2048	15,274
2049 - 2050	3,309
Total	\$ 126,704

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The Port has an option to purchase the leasehold premises for a purchase price equal to the present value of all the remaining Base Rent due from the Port to the sublandlord through the expiration date of the sublease. Rental payments totaled \$3,070,000 in 2008 and \$2,984,000 in 2007.

b. Litigation

The Port is a defendant in various lawsuits and claims; most deal with personal injury or property damage resulting from accident or fire and are covered by insurance. In the opinion of counsel the likelihood of an unfavorable outcome is probable in some of the suits and, accordingly, accrued liabilities include the aggregate amount of deductibles under applicable insurance policies. However, a number of the lawsuits are in the discovery stages and counsel to the Port cannot express an opinion as to the possible outcome of such litigation. Port's management believes that the ultimate resolution of such matters is not expected to have a material effect on the Port's financial position or results of operations.

c. Contingencies

Risk Management

The Port is subject to various risks of loss including general liability, property and casualty, workers' compensation and employee health and accident. The Port carries commercial insurance for substantially all risks of loss except workers' compensation and property damage to Port-owned vehicles. Additionally, tenants and contractors on all contracts are required to carry commercial general liability insurance in various amounts naming the Port as additional insured. The Port's property insurance does not cover losses due to seismic events. The Port is located in a seismically active region of California and its property is located within a liquefaction zone according to a report prepared by the California Geologic Survey. The loss of soil strength from liquefaction can cause significant damage to buildings and structures due to ground settlement or lateral spreading. In the event of a major local disaster, Federal and state emergency financial assistance should be available to cover certain costs for emergency response and repair of public facilities. Following the 1989 earthquake, the Port received \$27.8 million in federal and state emergency assistance for earthquake-related repairs.

Losses from workers' compensation claims of Port employees, the deductible portion of insured losses, and losses from other uninsured risks must be funded by current revenues or budgetary reserves. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. The administration of workers' compensation, including estimates of recorded and incurred but not reported claims, is provided by the City. The workers' compensation liability as of June 30, 2008 and 2007 has been evaluated by an independent actuary.

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Notes to Financial Statements

Changes in the reported liability reserves for 2008 and 2007 resulted from the following activity:

	General Liability		Workers' Compensation	
	2008	2007	2008	2007
	(in thousands)			
Beginning of the year	\$ 1,100	\$ 1,364	\$ 2,747	\$ 3,119
Current year claims and changes in estimate	300	162	507	100
Settlements	(279)	(426)	(711)	(472)
End of year	\$ 1,121	\$ 1,100	\$ 2,543	\$ 2,747

The general liability and workers' compensation liability reserves are included in accrued liabilities in the financial statements.

Grants

Certain grants that the Port receives are subject to audit and final acceptance by the granting agency based upon their review of costs incurred. Port's management does not believe that such audits will have a material impact on the financial statements.

Drydock #1

In November 2002, a maritime vessel known as Drydock #1 broke free from its moorings at Pier 70 and went adrift in very high winds, finally running aground on Yerba Buena Island. The recovered drydock is currently moored at a safer harbor location. The Port continues to evaluate options for the final disposition of this surplus vessel. Engineering consultants have assessed requirements for hazardous materials abatement, including potential remediation of lead-based paints, heavy-metal contaminated sediments, and asbestos. The consulting engineers also performed a preliminary structural assessment and condition survey to assess the viability of towing the vessel from its present location to a location for ultimate disposal. Based on its poor condition, the drydock is most likely only salvageable for scrap metal. Based on the information from various consultants and internal engineering estimates, \$2.8 million was accrued in 2008 for the drydock's final disposition, including the remediation of identified hazardous materials.

1. The first part of the paper discusses the importance of the study of the history of the United States. It is argued that the study of the history of the United States is essential for a full understanding of the country and its people. The paper then goes on to discuss the various methods used by historians to study the past, including the use of primary and secondary sources, and the importance of critical thinking in the study of history.

2. The second part of the paper discusses the role of the federal government in the development of the United States. It is argued that the federal government has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the federal government, and the impact of these policies and programs on the country and its people.

3. The third part of the paper discusses the role of the states in the development of the United States. It is argued that the states have played a central role in the development of the country, and that their actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the states, and the impact of these policies and programs on the country and its people.

4. The fourth part of the paper discusses the role of the courts in the development of the United States. It is argued that the courts have played a central role in the development of the country, and that their actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the courts, and the impact of these policies and programs on the country and its people.

5. The fifth part of the paper discusses the role of the people in the development of the United States. It is argued that the people have played a central role in the development of the country, and that their actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the people, and the impact of these policies and programs on the country and its people.

6. The sixth part of the paper discusses the role of the economy in the development of the United States. It is argued that the economy has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the economy, and the impact of these policies and programs on the country and its people.

7. The seventh part of the paper discusses the role of the culture in the development of the United States. It is argued that the culture has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the culture, and the impact of these policies and programs on the country and its people.

8. The eighth part of the paper discusses the role of the environment in the development of the United States. It is argued that the environment has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the environment, and the impact of these policies and programs on the country and its people.

9. The ninth part of the paper discusses the role of the military in the development of the United States. It is argued that the military has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the military, and the impact of these policies and programs on the country and its people.

10. The tenth part of the paper discusses the role of the foreign policy in the development of the United States. It is argued that the foreign policy has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the foreign policy, and the impact of these policies and programs on the country and its people.

11. The eleventh part of the paper discusses the role of the education in the development of the United States. It is argued that the education has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the education, and the impact of these policies and programs on the country and its people.

12. The twelfth part of the paper discusses the role of the health care in the development of the United States. It is argued that the health care has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the health care, and the impact of these policies and programs on the country and its people.

13. The thirteenth part of the paper discusses the role of the social services in the development of the United States. It is argued that the social services have played a central role in the development of the country, and that their actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the social services, and the impact of these policies and programs on the country and its people.

14. The fourteenth part of the paper discusses the role of the transportation in the development of the United States. It is argued that the transportation has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the transportation, and the impact of these policies and programs on the country and its people.

15. The fifteenth part of the paper discusses the role of the energy in the development of the United States. It is argued that the energy has played a central role in the development of the country, and that its actions have shaped the course of American history. The paper then goes on to discuss the various policies and programs of the energy, and the impact of these policies and programs on the country and its people.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

Environmental

Port lands are subject to environmental risk elements typical of sites with a mix of light industrial activities dominated by transportation, transportation-related and warehousing activities. Due to the historical placement of fill of varying quality, and widespread use of aboveground and underground tanks and pipelines containing and transporting fuel, elevated levels of petroleum hydrocarbons and lead are commonly found on Port properties. Consequently, any significant construction, excavation or other activity that disturbs soil or fill material may encounter hazardous materials and/or generate hazardous waste.

The Port has identified certain environmental issues related to Port property, including asbestos removal, fuel tank removal and oil contamination. The Port may be required to perform certain clean-up work if it intends to develop or lease the property, or at such time as required by the city or state. The Port projects currently estimable testing and remediation costs for these identified issues to be in the range of \$0.3 million to \$0.5 million of which \$0.5 million is accrued as of June 30, 2008. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for such risk cannot be reasonably made at this time.

The Port is coordinating with Pacific Gas and Electric Company (PG&E) for the removal of fuel pipelines at two Southern Waterfront locations. One pipeline, located at Pier 70 Wharf 8, provided fuel oil to the former PG&E Potrero Power Plant. Its removal by PG&E was substantially complete as of April 2008, with some shoreline restoration work pending. The other is an abandoned PG&E pipeline discovered at the Illinois Street Bridge project site near Pier 90, extending south from Islais Creek to the former Hunters Point Power Plant. The portion of the fuel pipeline located within the bridge project site has been removed by PG&E. Removal of the remainder is pending necessary permits and approvals.

There is abandoned construction debris at two industrial sites in the Southern Waterfront, hindering re-leasing and use of the affected premises. A concrete batch plant ceased operations at a site north of Pier 80, abandoning approximately 17,000 cubic yards of concrete debris. The other site at Pier 94 contains approximately 100,000 tons of material, consisting primarily of concrete and asphalt debris, left behind by a bankrupt recycling operation. The Port has assessed various options for processing and removal of the construction debris. Estimated costs totaling \$1.0 million for certain processing and removing have been accrued as of June 30, 2008.

**Port Commission
City and County of San Francisco
Port of San Francisco**

Notes to Financial Statements

The Port has been conducting a public planning process to produce a preferred master plan for an underutilized 65-acre area commonly known as “Pier 70”. A long history of heavy industrial use has turned this area into a “brownfield” – an underutilized property area where reuse is hindered by actual or suspected contamination. Environmental conditions likely exist that require investigation and remediation prior to any rehabilitation or development for adaptive reuse. The lack of adequate information about environmental conditions has hindered previous development proposals for Pier 70. With assistance from a federal grant, the Port intends to proceed in fiscal 2008-09 with a brownfields site investigation throughout the Pier 70 area and to complete a risk assessment and feasibility study. It is anticipated that the grant will also fund the removal or abatement of certain identified hazardous building materials (i.e. asbestos, lead-based paint). The amount of hazardous building materials abatement that can be accomplished will depend on the amount of funds available.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO**

Independent Auditor's Report,
Management's Discussion and Analysis, and
Basic Financial Statements

For the Year Ended
June 30, 2009



MACIAS GINI & O'CONNELL LLP

4. The fourth part of the document discusses the implications of the findings. It suggests that the results have significant implications for the field of study and may lead to further research in this area.

5. The fifth part of the document concludes the study. It summarizes the key findings and provides a final statement on the importance of the research.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO**

Independent Auditor's Report,
Management's Discussion and Analysis, and
Basic Financial Statements

For the Year Ended
June 30, 2009

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**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO**

For the Year Ended June 30, 2009

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MACIAS GINI & O'CONNELL LLP
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SACRAMENTO

OAKLAND

LOS ANGELES

NEWPORT BEACH

SAN DIEGO

The Honorable Mayor and Board of Supervisors
San Francisco, California

Independent Auditor's Report

We have audited the accompanying financial statements of the Port Commission, City and County of San Francisco (City), Port of San Francisco (Port), an enterprise fund of the City, as of and for the year ended June 30, 2009, as listed in the table of contents. These financial statements are the responsibility of the Port's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Port's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Port are intended to present the financial position, changes in financial position, and cash flows, of only that portion of the business-type activities and major fund of the City that is attributable to the transactions of the Port. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2009, the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Port as of June 30, 2009, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, the Port adopted the provisions of Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, on July 1, 2008.

The Management's Discussion and Analysis identified in the accompanying table of contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of

measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Macias Gini & C. Counsel LLP
Certified Public Accountants

Walnut Creek, California
December 1, 2009

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO**

**Management's Discussion and Analysis (Unaudited)
For the Year Ended June 30, 2009**

Introduction

This discussion and analysis is a narrative overview and analysis of the financial activities of the Port of San Francisco (Port). It serves as an introduction to the audited financial statements, which can be found on pages 14 - 19 of this report. This overview should be read in conjunction with the more detailed information contained within the accompanying financial statements.

The Port is a self-supporting enterprise department of the City and County of San Francisco (City) and its financial statements are included in the City's basic financial statements. Only the accounts of the Port are included in the financial statements that follow. The Port Commission is responsible for seven and one-half miles of waterfront property, which was transferred in trust from the State of California to the City in 1969. The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations, which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Additional information concerning the Port's organization and the basis of presentation for this financial report is contained in Note 1 and Note 2 to the financial statements (pages 21 - 25).

Financial Statement Overview

The statement of net assets presents information on all of the Port's assets and liabilities, with the difference between the two reported as "net assets." Increases and decreases in net assets serve as a useful indicator of the financial position of business enterprise entities like the Port.

The statement of revenues, expenses and changes in net assets presents information showing how the Port's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g. uncollected rents from tenants and earned and unused vacation leave).

The statement of cash flows presents information about the cash receipts and cash payments of the Port during the most recent fiscal year. This statement shows the effects on financial position of cash operating, investing, capital, and financing transactions. When used with related disclosures and information in the other financial statements, the information in the statement of cash flows helps readers assess the Port's ability to generate net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

The notes to financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes follow the financial statements and can be found on pages 21 - 45 of this report.

Certain amounts presented in the June 30, 2008 audited financial statements have been reclassified for comparative purposes to conform to the presentation in the June 30, 2009 financial statements.

Following is a presentation of certain condensed financial information derived from the basic financial statements.

**PORT COMMISSION
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Management's Discussion and Analysis (Unaudited)
For the Year Ended June 30, 2009

Condensed Financial Information – Port of San Francisco

Comparative Net Assets (in thousands)

	June 30,		2009-2008
	2009	2008	Change
Current and other assets	\$ 109,171	\$ 102,676	\$ 6,495
Capital assets	258,754	262,061	(3,307)
Total assets	367,925	364,737	3,188
Long term debt obligations	8,063	11,426	(3,363)
Other liabilities	69,729	65,650	4,079
Total liabilities	77,792	77,076	716
Net assets:			
Invested in capital assets, net of related debt	255,012	256,723	(1,711)
Restricted	3,459	617	2,842
Unrestricted	31,662	30,321	1,341
Total net assets	\$ 290,133	\$ 287,661	\$ 2,472

Changes in Net Assets (in thousands)

	Year Ended June 30,		2009-2008
	2009	2008	Change
Revenues:			
Operating revenues	\$ 66,467	\$ 64,498	\$ 1,969
Nonoperating revenues	2,596	3,613	(1,017)
Capital contributions	5,202	3,942	1,260
Total revenues	74,265	72,053	2,212
Expenses:			
Operating expenses	71,234	66,922	4,312
Nonoperating expenses	559	4,449	(3,890)
Total expenses	71,793	71,371	422
Change in net assets before special items	2,472	682	1,790
Special items	-	198	(198)
Change in net assets	2,472	880	1,592
Net assets, beginning of the year, as restated	287,661	286,781	880
Net assets, end of the year	\$ 290,133	\$ 287,661	\$ 2,472

Financial Analysis

Assets exceeded liabilities by \$290,133,000 at the close of the most recent fiscal year. Total net assets as of June 30, 2009 increased \$2,472,000 from June 30, 2008, as restated. This increase follows an \$880,000 increase posted for the previous fiscal year. As discussed more fully in Note 2 to the basic financial statements, net assets at the beginning of the year have been restated for existing pollution

**PORT COMMISSION
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**Management's Discussion and Analysis (Unaudited)
For the Year Ended June 30, 2009**

remediation obligations of approximately \$27,500,000 to implement a new accounting standard and adjustments for depreciation of approximately \$15,500,000 that should have been recorded in prior years. Revenues continue to increase modestly. Capital contributions revenues include the first-time allocation of proceeds from a City general obligation bond to be spent on open space and park improvement projects. Nonrecurring revenue transactions and expenses continue to drive many year-to-year variances. The more significant variances and nonrecurring transactions are discussed below in more detail.

The largest portion of the Port's net assets, 88 percent at June 30, 2009 and 89 percent at June 30, 2008, reflects its investment in capital assets net of related debt. The Port is responsible for a seven and one-half mile stretch of waterfront land and its revenue is derived primarily from property rentals to commercial and industrial enterprises and a diverse mix of maritime operations. As disclosed in Note 2 to the financial statements, land transferred from the State of California to the City is reported at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State to reflect appraised values in 1929. The total amount of net assets tied to capital assets (\$255,012,000 at June 30, 2009) represents assets that are not available for future spending. Although the investment in capital assets is reported net of related debt, the resources needed to repay the debt must be provided from other sources (i.e. other Port assets or operating revenues). The capital assets themselves cannot be used to liquidate those liabilities. The remaining portion of net assets at June 30, 2009 consists of \$3,459,000 restricted for specific expenditures and \$31,662,000 that is unrestricted and available to meet future capital requirements and ongoing obligations.

The statement of revenues, expenses and changes in net assets on page 17 presents the Port's operating revenues in more detail by industry revenue types. Operating revenues for the year ended June 30, 2009 increased \$1,969,000 or 3.1%, which is less than the \$3,305,000 or 5.4% increase for the year ended June 30, 2008. Overall property rentals across all revenue types posted a net increase of \$1,601,000 in 2009: \$2,223,000 increase from minimum or base rentals and offset by \$622,000 decreases from percentage rents over minimum base rents ("overage rents"). Parking-related revenues, which include lots leased to parking operators, parking stalls, parking meters on Port streets and fine revenues collected by the City on Port property, have also grown steadily in recent years. Cruise revenues have dropped after a peak in 2006 which had 98 cruise calls. There were 63 and 47 cruise calls in 2009 and 2008, respectively.

Other operating revenues include permit fees, various one-time fees realized from major development projects and grant funds received to support an operating activity. Revenues on this line fluctuate from year to year since they are largely derived from specific transactions and construction activities on Port property.

Capital grants and other contributions consist principally of funds from federal, state and local grant agencies which provide funding for several of the Port's capital projects. This revenue source fluctuates widely, based on grant funds availability and the capital work actually in progress at the Port. In 2009, the Port also received \$3,644,000 from the first issuance of the City's 2008 Clean and Safe Neighborhood Parks General Obligation Bond to fund designated open space projects on Port property.

Total expenses of \$71,793,000 for 2009 represent a \$422,000 increase from 2008. Nonrecurring charges have accounted for many expense variances in recent years. Some regular operating budget items like workers compensation and insurance continue to fluctuate, but normalization is expected in future periods.

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**Management's Discussion and Analysis (Unaudited)
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The more significant cost and expense changes in 2009 included the following:

	Increase / (Decrease) 2009
Professional services	\$ 1,064,000
Depreciation and amortization	993,000
Salary and fringe benefit costs	847,000
Services provided by City departments	777,000
Judgment and litigation expenses	412,000
System consulting services	273,000
Postemployment benefits other than pensions	207,000
Allocated City indirect costs	203,000
Licenses and permits	150,000
Marketing and promotion	119,000
Utilities	(104,000)
Dredging amortization expense	(182,000)
Security	(241,000)
Removal of abandoned construction debris	(350,000)
Asset disposition and project abandonment	(3,752,000)

Total service reimbursements to other City departments were \$12,846,000 in 2009 and \$12,069,000 in 2008. In 2004, the Port Commission adopted the findings of a nexus study that analyzed the balance of payments between the Port and City. That study established a record of certain past expenditures and provided a systematic means for determining the balance of payments for future periods. The Port and City continue to evaluate and refine the methodologies used for the reimbursement and allocation of direct and indirect costs. Currently, most City direct services are settled through the City's interdepartmental work order process. The \$777,000 increase in 2009 includes in-progress drydock maintenance on one fireboat, Embarcadero roadway maintenance and project support from the Department of Public Works, supplemental staff assistance from the Department of Real Estate to negotiate hold-over leases, and additional services from the City Risk Manager.

Salary and mandatory fringe benefit costs, pursuant to collective bargaining arrangements, continue to increase, particularly for pension and health plan costs. Other cost fluctuations can be attributed to various factors, including headcount changes, temporary salaries, and changes in the amount of capitalized labor (i.e. labor captured as part of capital improvement work and excluded from operating expenses). Personnel cost increases in 2009 were off-set to some extent by increases in capitalized labor and slight decrease in headcount. Full-time equivalent headcount at June 30, 2009 is 229 versus 231 at 2008. In accordance with an accounting requirement effective June 30, 2008, a \$3.0 million and \$2.8 million charge was recorded in 2009 and 2008, respectively, for retiree benefits other than pensions (i.e. retiree medical benefits). Currently, these retiree benefits are principally funded on a "pay-as-you-go" basis. In accordance with the new accounting standard, the City has allocated the annual required contribution computed by consulting actuaries proportionately to departments based on the current payroll costs of covered employees.

As discussed in more detail in Note 16, final disposition cost of \$2.8 million for Drydock #1 was accrued in 2008. No large dispositions or project abandonments were recorded in 2009.

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Management's Discussion and Analysis (Unaudited)
For the Year Ended June 30, 2009

Capital Asset and Debt Administration

Capital assets

The Port's investment in capital assets as of June 30, 2009 and 2008, respectively, amounted to \$258.8 million and \$262.1 million, net of accumulated depreciation. This investment in capital assets includes land, certain street and road improvements, pier promenades, pier substructure, buildings and related improvements, vehicles, equipment and furniture. Additional information on the Port's capital assets can be found in Note 5 on page 28 of this report.

Recent major capital asset events included the following:

- ***Pier 24 Annex, Substructure and Superstructure.*** This is a new tenant build-out financed in part by \$3 million Port rent credits against the tenant's minimum rent obligation over a ten-year period. The tenant build-out includes core and shell construction elements, such as roof replacement, new mechanical systems and substructure repair. This tenant project addresses extensive deterioration to major structural elements that limited usability of the entire pier shed.
- ***Pier 45 Apron.*** This \$2.8 million project commenced several years ago to address apron areas that were found to be structurally deficient and taken out of service. The original project contemplated replacement of over 250 piles and several deck substructure repairs to restore these areas for safe use. The work completed to date was moved from the construction-in-progress account to facilities and improvements in 2009. Additional work is planned for the east apron.
- ***Energy Efficiency Project.*** In 2006, the Port partnered with San Francisco Public Utilities Commission (SFPUC) and completed an energy audit that covered lighting, heat, ventilating, and air conditioning (HVAC), and refrigeration systems in areas for which the Port directly paid energy bills. Contract work for recommended lighting retrofits was completed in 2009 (\$728,000). The HVAC and refrigeration portion will proceed in fiscal 2009-2010. It is anticipated that retrofit costs will be recovered through future energy cost savings, as well as provide environmental benefits for the wider community through reduced air pollution and greenhouse gas emissions.
- ***Illinois Street Intermodal Bridge.*** The bridge is constructed over Islais Creek and extends Illinois Street from the north side of the creek, adjacent to the Pier 80 cargo terminal, to Pier 90 on the south side of the creek and provides for replacement freight rail service to Pier 80. The bridge also provides for two-way vehicular traffic across the bridge; opening of the bridge for watercraft in the creek; and bicycle and pedestrian access across the bridge.

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- ***Pier 52 Boat Launch Facility.*** This \$3.5 million project resulted in a new public boat launch at Pier 52. It replaces a single-lane facility built in the 1950s. The new facility includes a two-lane boat launch, a fully accessible landing float, loading floats, lighting and signage and shoreline protection and improvements. A parking lot was completed previously for \$0.5 million; it includes 40 spaces capable of handling vehicles with trailers and a small timber structure to house an oil recycling shed.
- ***Pier 33 Roofing and Related Structural Repair Project.*** This \$2.4 million project scope included re-roofing the shed, dry-rot repairs to wood decking and structural framing, repairs and refurbishing of the rooftop light monitors, window replacements and required hazardous material abatement.
- ***Security Fencing.*** Funding provided from the Department of Homeland Security's Urban Area Security Initiative and the State of California Homeland Security grant programs funded \$0.9 million of replacement fencing at multiple Port facilities. The new fencing assists the Port toward compliance with security mandates applicable to facilities regulated under the Maritime Transportation Act of 2002. Additional security fence improvements have been programmed and are expected to be completed in fiscal 2010-2011.

At June 30, 2009, \$57.0 million remain appropriated and available to be expended for various capital projects, including pier repair and major maintenance or improvements. Facility condition surveys are performed by Port Engineering to identify and prioritize immediately required maintenance projects that preserve and extend the economic life of the Port's productive assets.

The Port had firm purchase and contract commitments at June 30, 2009 for approximately \$7.2 million for capital projects and \$2.6 million for general operations.

Debt administration

Detailed information concerning the Port's long-term obligations can be found in Note 7 on pages 29-30 of this report. As of June 30, 2009, the Port had total long-term obligations of \$8,063,000 including \$4,473,000 that is due during the next fiscal year. Long-term obligations consist of \$4,320,000 in revenue bonds, \$3,015,000 in loans that are secured by specified revenue sources and \$728,000 advance from SFPUC for the energy efficiency project. The decrease of \$3,363,000 from the prior year relates primarily to principal payments on the debt.

The revenue bonds were fully repaid on their final maturity date of July 1, 2009. New revenue bonds are expected to be issued in fiscal 2009-2010.

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For the Year Ended June 30, 2009

Economic and Other Factors

In accordance with the City's Administrative Code Section 2.30, the Port updates its ten-year capital plan annually. The most current update resulted in the identification of capital projects totaling more than \$2.0 billion. Approximately 50% or just over \$1.0 billion of the total addresses renewal and repair of existing facilities or deferred maintenance. Potential funding sources have been identified for approximately 33% of the \$2.0 billion total. The \$650 million in identified funding is \$154 million less than the identified funding of \$804 million in last year's plan, reflecting the withdrawal of a developer from the Piers 27 – 31 project, leaving needed pier repair and seismic upgrade work unfunded. Approximately \$1.4 billion are in unfunded projects – projects for which the Port (1) does not expect to have sufficient funds to cover the estimated costs to repair and upgrade the facility, and (2) has not issued a request for proposals (RFP) or entered into negotiations with a developer to finance the upgrades. Several funding options may exist to address this unmet need, such as future development projects and grant opportunities. Each new funding option will require substantial staff time to develop and implement as well as support from policy makers and, in the case of potential development projects, the support of the California State Lands Commission and the San Francisco Bay Conservation and Development Commission.

The Port has pursued State legislative changes to increase funding options to address future capital requirements. Senate Bill No. 1085, signed by Governor Arnold Schwarzenegger in September 2005, amended the California Government Code to authorize public trust grantees in San Francisco to form infrastructure financing districts pursuant to Section 53395 et seq. This legislative amendment incorporates changes that enable the City and Port to apply this code section to the Port area. Among other things, it authorizes the use of an infrastructure financing district for urban waterfront areas in addition to undeveloped or underdeveloped areas; specifically clarifies that publicly-owned property subject to tidelands trust for commerce, navigation and fisheries (the "public trust"), including filled tidelands, may be included in such districts; and enumerates additional examples of infrastructure improvements that qualify for infrastructure financing districts, including seismic upgrades, historic renovation, environmental remediation, utility improvements, and structural repair or construction of seawalls, piers and wharves. Infrastructure financing districts is a mechanism public agencies use to finance public infrastructure improvements by capturing and bonding against tax revenue increments generated in the district after it is established. Future steps include: defining the boundaries of a district, developing the infrastructure plan and obtaining approval from the Board of Supervisors. In October 2007, Governor Arnold Schwarzenegger signed Senate Bill No 815 which authorizes the lifting of public trust use restrictions on specified seawall lots for a period of time to expire on January 1, 2094 and the removal of the public trust on certain paper streets. The lifting of public trust use restrictions on the lots increases the options for capital investment and future revenue. Revenues from "nontrust" leases beyond a defined baseline must be expended for the preservation of historic piers and structures or the construction and maintenance of certain waterfront plazas and open space.

The City's ten-year capital plan has programmed general obligation bond measures for park projects. The first park bond approved and authorized, 2008 Clean and Safe Neighborhood Parks, included \$33.5 million for open space projects on Port property. Port projects include a promenade at Pier 43½ in Fisherman's Wharf; the Brannan Street Wharf Park in South Beach; Bayfront Park in the China Basin area; and, in the Southern Waterfront, Crane Cove Park, Warm Water Cove Park, Islais Creek, and an entrance to Heron's Head Park. In fiscal 2008-2009 using funds from the first bond issuance, the Port initiated planning and design efforts for these open space projects.

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The Port has entered into a number of public/private partnerships with developers for the historical preservation, renovation, and redevelopment of certain Port properties. Current information concerning major development projects and opportunities can be found at the Port's website: www.sfport.com. Recent development project activities and events include:

Seawall Lot 337 and Pier 48 – In October 2007, the Port Commission authorized a two-step Request for Qualifications/Request for Proposals (RFQ/RFP) process to select a developer for creation of major waterfront public open space and urban mixed use project on Seawall Lot 337 and a complementary use program for Pier 48. Seawall Lot 337 is one of the lots covered by Senate Bill No. 815, allowing for, under certain conditions, the lifting of public trust use restrictions that cover most Port properties. Four development teams responded to the RFQ. In August 2008, the Port consented to the merger of two development teams into a single entity. At its May 12, 2009 meeting, the Port Commission awarded the RFP to the merged team and entered into exclusive negotiations for a Lease Disposition and Development Agreement ("LDDA").

The Exploratorium Museum at Piers 15 – 17 – The Exploratorium, a museum of science, art and human perception, intends to rehabilitate, repair and seismically upgrade the Pier 15 bulkhead building, shed and connector building and relocate the museum into Pier 15 from its current location at the Palace of Fine Arts. Pier 15 will provide areas for displays and exhibits, a museum store, cafe, exhibit fabrication areas, classrooms, theatre, and ancillary offices. A new "Observatory Building", replacing an existing connector building at the east end of Pier 15, will be connected to the Pier 15 shed by a one-story structure. The Observatory Building will house a café on the first floor, exhibit and event space on the second floor, and a rooftop terrace. The Exploratorium hopes to expand the museum into Pier 17 in the future; initially, The Exploratorium intends to use portions of Pier 17 for museum-related uses and sublease the remainder of the pier to various subtenants. The paved asphalt decking in the valley between the two piers will be removed to expose the Bay, and a new deck will be built to provide public access to the Bay. This outdoor area will include both a ticketed area and free public access areas for the public to enjoy the Bay. There will be additional public access around the perimeter of the piers providing unsurpassed views of the Bay Bridge, Treasure Island and the East Bay hills.

The Board of Supervisors passed a resolution in June 2005 exempting the potential lease from the competitive bidding process required by Administrative Code Section 2.6-1. The Port Commission approved an agreement for exclusive negotiations with The Exploratorium in February 2006. A City required fiscal feasibility report was originally approved by the Board of Supervisors in July 2006. The subsequent amendment to add Pier 17 to the lease for possible future expansion of the museum was approved by the Port Commission and the Board of Supervisors in 2008. The project's Environmental Impact Report was certified by the City Planning Commission on July 9, 2009. Approvals from the State Lands Commission and the Bay Conservation and Development Commission ("BCDC") to complete the entitlement process for the project are expected by the end of the calendar year. A major permit from BCDC is also required for the project.

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Piers 1½-3-5 – This project entails the rehabilitation of historic bulkhead buildings with ground floor restaurants, upper floor office, public access walkways and guest boat dock. Shell construction was completed in 2007 and subleasing is continuing. In 2009, all 18,000 square feet of retail space has been subleased. La Mar Cebicheria Peruana, the first of the restaurants, opened in September 2008. The Plant Organic Café opened in June 2009 and the Laffitte Restaurant has applied for a building permit.

Brannan Street Wharf – This project entails the removal of Pier 36 and construction of a new 55,000 square foot open space over the water between Piers 30-32 and 38. The Brannan Street Wharf will include neighborhood green, public float and interpretative exhibits about the Bay Concept design for Brannan Street Wharf is completed and engineering design drawings are in progress. The original development agreement between the Port and a developer for the Bryant Street Piers Mixed Use and Cruise Terminal Project expired in September 2006, without the developer exercising an option to extend the term of the Lease Disposition and Development Agreement. A residential condominium tower project (Phase 1), built on a portion of Seawall Lot 330 sold to the developer, was completed in April 2006 and all 136 residential units have been sold. Concept design for the Phase 2 bayfront urban park ("Brannan Street Wharf") was also completed. Certain proceeds from the land sale (\$9,000,000) remain specifically committed to the construction of the Brannan Street Wharf. The 2008 Clean and Safe Neighborhood Parks bond also includes \$2.9 million for this project.

Pier 27 Terminal – The Port is developing a new cruise terminal at Pier 27. This pier has a 1,358 foot berth and an existing shed of 178,123 square feet that will be renovated into the Port's primary cruise terminal. A portion of the Pier 27 shed will be demolished in order to create a two-acre plaza along the Embarcadero. The Pier 27 valley will serve as a vehicular circulation area to allow efficient handling of passengers and to reduce traffic congestion. Pier 27 will also be equipped with a shoreside power installation to reduce cruise ship air emissions. A contract with a design consultant was awarded in November 2009.

Seawall Lot 351 – This two-thirds of an acre site at Embarcadero and Washington Streets is currently a surface parking lot. A Request for Proposal was authorized on July 8, 2008 for a mixed use project. Required uses are retail, restaurant and visitor parking. On February 24, 2009, the Port Commission authorized exclusive negotiations with a developer who intends to combine the site with a contiguous tennis club property. A community planning process is underway to develop community consensus for a development program and design for the project.

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Various development and planning activities are also being directed at master planning for the Pier 70 area and at feasibility analyses for environmental, engineering and economic viability of development and leasing in the Piers 90-94 Backlands:

Pier 70 Area – The Port is in the latter stages of developing a Pier 70 Master Plan. A draft preferred plan was issued on July 15, 2009. Pier 70 is located on San Francisco's Central Waterfront, an approximately 65-acre site, generally between 18th and 22nd Streets, east of Illinois Street. For over 150 years, some portion of this site has been in use for ship building and repair or steel production, as well as for other supporting heavy industrial uses. The Port and community have identified a number of goals in the development of the master plan, including retention of the ship repair facility, historic preservation of key buildings, environmental remediation and the development of shoreline public open space.

Backlands at Piers 90-94 – The Piers 90-94 Backlands area is an approximately 45-acre site located immediately south of Islais Creek and is part of the Port's Piers 80-96 maritime cargo area. The Port is working to determine lease uses that are compatible with the surrounding maritime complex and consistent with public trust requirements. Because the site was created with unengineered fill, any significant new structures at the site would require pile-supported foundations.

Economy

Uncertainties concerning the global and domestic economic condition impact the Port. The national focus on homeland security from acts of terrorism initially reduced tourist travel and tourist-dependent revenues in the City. While the recent recession has certainly affected many tenants, the Port's restaurant and retail tenants generally report steady sales activity. Commercial office vacancies and large sublease opportunities in the central business district continued to rise in 2009, increasing negative absorption. In direct contrast, the Port has been able to maintain its monthly rent roll. Recurring monthly base rents were stable in 2009. Note 8 (page 32) contains required financial statement disclosure information covering the future rental income stream from minimum rents over the noncancellable term of active operating leases. The Port anticipates that it will be able to maintain revenues at current levels with a minimum modest year-to-year growth. Revenue loss to the Port during down periods has been generally limited to some decline in overage rents (percentage rents above the minimum based on tenant sales) and some increase in delinquencies and write-offs.

While the revenue side shows strength, the broader economic climate retains a great deal of uncertainty and challenges on the cost side: unstable fuel costs, fluctuating cost of construction materials, supply chain disruptions due to natural or man-made disasters, etc. These general economic conditions are taken into consideration when preparing budgets and forecasts.

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For the Year Ended June 30, 2009

San Francisco Waterfront Special Area Plan. In July 2000, the Port and the San Francisco Bay Conservation and Development Commission (BCDC) agreed to amend the Port's Waterfront Land Use Plan and BCDC's San Francisco Bay Plan to create consistent plans for the waterfront area between the Hyde Street Pier and China Basin (Special Area Plan). Among other things, the Special Area Plan commits the Port to expend up to \$30 million over a 20-year period for the removal of certain piers and the construction of major public plazas and other public access improvements. The Port is permitted to seek and use other funding sources (i.e. grants and contributions) to finance the required pier removals and public access improvements. Until sufficient funding from other sources is secured, the Port may need to commit significant capital funds in future years for Special Area Plan projects. As of June 30, 2009, \$16.7 million of Port funds has been appropriated and \$2.0 million has been expended for projects under the agreement. Future proceeds from the Clean and Safe Neighborhood Parks bond will provide \$2.9 million for the Brannan Street Wharf project. Assembly Bill No. 1389, signed by former Governor Gray Davis in October 2001 to authorize approval of the development plans for a cruise ship terminal at Piers 30-32, also ratified the Special Area Plan adopted by the Port and BCDC.

Port security. The Port participates in a regional Port Security Committee, which reviews security issues and needs affecting ports and terminals in the San Francisco Bay Area. Since 2005, the Port has had a full-time homeland security manager responsible for developing, directing, overseeing and implementing a comprehensive security program mandated by the federal government. As a department of the City and as a California port, the Port of San Francisco has been allocated funds under the Port Security Grants Program, managed by the Transportation Security Administration, and other Department of Homeland Security programs to plan for and to implement effective response to emergent threats to Port and City property.

Contacting the Port's Financial Management

This report is designed to provide a general overview of the Port of San Francisco's finances. The financial statements and related informative disclosures in the notes to the financial statements are presented in accordance with the accounting and reporting standards known as "generally accepted accounting principles." Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Public Information Officer at Port of San Francisco, Pier 1, San Francisco, California, 94111.

Questions concerning the City and County of San Francisco or requests for a copy of the City's Comprehensive Annual Financial Report should be addressed to: Office of the Controller, City and County of San Francisco, at City Hall, Room 316, 1 Dr. Carlton B. Goodlett Place, San Francisco, California 94102.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO**

Statement of Net Assets
June 30, 2009
(dollar amounts in thousands)

Assets

Current assets:

Unrestricted:

Cash and investments, held in City Treasury (Note 3)	\$ 85,094
Cash held outside of City Treasury (Note 3)	5
Accounts and grants receivable, net (Note 4)	5,360
Accrued interest receivable	260
Materials and supplies	<u>1,161</u>
Total unrestricted current assets	<u>91,880</u>

Restricted:

Cash and investments, held in City Treasury (Note 3)	9,364
Deposits and investments outside of City Treasury (Note 3)	<u>7,058</u>
Total restricted current assets	<u>16,422</u>
Total current assets	<u>108,302</u>

Noncurrent assets:

Capital assets (Note 5):

Nondepreciable	111,739
Depreciable, net	<u>147,015</u>
Capital assets, net	258,754

Unrestricted other noncurrent assets (Note 6)	<u>869</u>
Total noncurrent assets	<u>259,623</u>
Total assets	\$ <u>367,925</u>

The accompanying notes are an integral part of these financial statements.

**PORT COMMISSION
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Statement of Net Assets (Continued)

June 30, 2009

(dollar amounts in thousands)

Liabilities

Current liabilities:

Accounts payable and accrued expenses	\$ 4,797
Accrued interest payable	199
Accrued payroll	1,369
Accrued vacation and sick leave pay (Note 7)	1,138
Accrued workers' compensation (Notes 7 & 17)	365
Estimated claims payable (Notes 7, 16 & 17)	600
Pollution remediation obligations (Notes 7 & 16)	494
Current maturities of long term obligations (Note 7)	4,416
Current portion of loan from City department (including accrued interest payable of \$8) (Notes 7 & 13)	65
Other liabilities	1,594
Deferred credits	1,798
Lessee and other deposits	6,361
Total current liabilities	23,196

Noncurrent liabilities:

Accrued vacation and sick leave pay (Note 7)	864
Accrued workers' compensation (Notes 7 & 17)	1,942
Other postemployment benefits obligation (Notes 7 & 11)	5,816
Estimated claims payable (Notes 7 & 16)	300
Pollution remediation obligations (Notes 7 & 16)	27,500
Long term obligations - net of current maturities (Note 7)	2,919
Loan from City department, net of current portion (Notes 7 & 13)	671
Other liabilities (Notes 7 & 16)	2,800
Deferred credits	11,784
Total noncurrent liabilities	54,596
Total liabilities	77,792

Net assets

Invested in capital assets, net of related debt	255,012
Restricted net assets for capital projects	3,459
Unrestricted net assets	31,662
Total net assets	\$ 290,133

The accompanying notes are an integral part of these financial statements.

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**PORT COMMISSION
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Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2009
(dollar amounts in thousands)

Operating revenues:		
Commercial and industrial	\$	41,819
Parking		10,697
Cargo		4,655
Fishing		1,972
Cruise		1,924
Harbor services		991
Ship repair		975
Other maritime		1,535
Other		1,899
Total operating revenues		66,467
Operating expenses:		
Personal services		29,238
Contractual services		5,773
Utilities		1,929
Materials and supplies		1,618
Depreciation and amortization		13,348
General and administrative		4,359
Services provided by other City departments		12,846
Other		2,123
Total operating expenses		71,234
Operating loss		(4,767)
Nonoperating revenues (expenses):		
Interest and investment income		2,596
Interest expense		(544)
Loss on disposal of capital assets		(15)
Total net nonoperating revenues		2,037
Change in net assets before capital contributions		(2,730)
Capital contributions:		
Grants from government agencies and other contributions		5,202
Change in net assets		2,472
Net assets, beginning of the year, as previously reported		330,687
Prior period adjustments (see Note 2)		(43,026)
Net assets, beginning of the year, as restated		287,661
Net assets, end of the year	\$	290,133

The accompanying notes are an integral part of these financial statements.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Statement of Cash Flows
For the Year Ended June 30, 2009
(dollar amounts in thousands)

Cash flows from operating activities:	
Cash received from tenants for rent	\$ 56,398
Cash received from customers and others	7,265
Deposits received from tenants and customers	533
Cash paid to employees for services	(26,106)
Cash paid to suppliers for goods and services	(14,839)
Cash paid to the City and County of San Francisco for services	(12,406)
Customer deposits returned	(789)
Net cash provided by operating activities	<u>10,056</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of facilities and equipment	(4,050)
Dredging	(3,369)
Payments of long-term debt	(4,277)
Interest payments on long-term debt	(371)
Capital grants received	1,847
Capital contribution received from City (Park Bond)	3,644
Proceeds from sale of equipment and materials	13
Net cash used in capital and related financing activities	<u>(6,563)</u>
Cash flows from investing activities:	
Interest and investments income	<u>4,405</u>
Net cash provided by investing activities	<u>4,405</u>
Change in cash and cash equivalents	7,898
Cash and cash equivalents, beginning of year	<u>93,183</u>
Cash and cash equivalents, end of year	<u>\$ 101,081</u>

The accompanying notes are an integral part of these financial statements.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Statement of Cash Flows (Continued)
For the Year Ended June 30, 2009
(dollar amounts in thousands)

Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$	(4,767)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization		13,348
Change in allowance for doubtful accounts		421
Net effects of (increase) decrease in:		
Receivables		(1,209)
Tenant deposits held outside Treasury		189
Materials and supplies		90
Prepaid insurance and other assets		(32)
Net effects of increase (decrease) in:		
Accounts payable and accrued expenses		617
Accrued payroll		122
Accrued vacation and sick leave payable		61
Accrued workers' compensation		(236)
Other postemployment benefits obligation		3,011
Estimated claims payable		(221)
Pollution remediation obligations		114
Loan from City department		653
Deferred credits and other liabilities		(2,105)
Net cash provided by operating activities	\$	<u>10,056</u>
Noncash capital and related financing activities:		
Acquisition of capital assets in accounts payable and accrued expenses	\$	1,803
Tenant improvements financed by rent credits		1,315
Reconciliation of cash and equivalents to the statement of net assets:		
Cash and investments held in City Treasury		
Unrestricted	\$	85,094
Restricted		9,364
Cash held outside City Treasury		
Unrestricted		5
Restricted		<u>7,058</u>
Cash and equivalents		101,521
Less: Investment outside of City Treasury not meeting the definition of cash equivalents		<u>(440)</u>
	\$	<u>101,081</u>

The accompanying notes are an integral part of these financial statements.

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**PORT COMMISSION
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Notes to Financial Statements
For the Year Ended June 30, 2009

1. Organization

The Port of San Francisco (Port) is an enterprise fund of the City and County of San Francisco (City). Only the accounts of the Port are included in these financial statements. There are no component units that should be considered for inclusion in the Port's financial reporting entity. A five-member Port Commission is responsible for its operation, development, and maintenance. Commission members are appointed by the City's Mayor for fixed terms of four years. The Port is an integral part of the City, and the accompanying financial statements are included in the City's basic financial statements.

Prior to February 1969, the Port was owned by the State of California (State) and administered by the San Francisco Port Authority, a State agency. In February 1969, the State transferred the Port in trust to the City under the terms and conditions specified in the State statutes of 1968, Chapter 1333 (Burton Act), as amended, and ratified by the City's voters in November 1968. Under the terms of the Burton Act, the State Legislature reserved the right to amend, modify, or revoke, in whole or in part, the transfer of lands in trust, provided that the State would then assume all lawful obligations related to such lands.

The Port's revenue is derived primarily from property rentals to commercial and industrial enterprises and from maritime operations which include cargo, ship repair, fishing, harbor services, cruise and other maritime activities. Substantially all of the Port's property rental customers are located within the boundaries of the City. Port revenues are held in a separate fund (Harbor Fund) and are appropriated for expenditure pursuant to the budget and fiscal provisions of the City Charter, consistent with trust requirements. Under public trust doctrine, the Burton Act, and the transfer agreement between the City and the State, these revenues may be spent only for uses and purposes of the public trust.

2. Significant Accounting Policies

Basis of Accounting

The Port's financial statements are prepared using the economic resources measurement focus and the accrual basis in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Port applies all applicable Financial Accounting Standards Board (FASB) pronouncements (and authoritative literature of predecessor standard setters) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Port has elected not to apply private sector standards issued after November 30, 1989. In accordance with GASB Statement No. 34 (GASB 34), *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, the statement of net assets presents the difference between assets and liabilities as net assets. Net assets are reported in three broad components, as applicable – invested in capital assets, net of related debt; restricted; and unrestricted. Under the all-inclusive approach to presenting the changes in net assets, all Port revenues, including capital contributions, are reported in the statement of revenues, expenses and changes in net assets.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
PORT OF SAN FRANCISCO**

Notes to Financial Statements
For the Year Ended June 30, 2009

2. Significant Accounting Policies (Continued)

When both restricted and unrestricted resources are available for use, it is the Port's policy to use restricted resources first, then unrestricted resources as they are needed.

Cash Equivalents

The Port considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Port's cash and investments in the City Treasury are, in substance, demand deposits and are considered cash equivalents.

Investments

The Port reports its investments at fair value in the accompanying financial statements and the corresponding change in fair value of investments is reported in the year in which the change occurs. Fair value is based upon quoted market prices.

Restricted Cash and Investments

Assets whose use is restricted to specific purposes by bond indenture or otherwise are segregated on the statement of net assets. These assets are primarily restricted for construction and debt service purposes. Bond interest and redemption represent funds accumulated for debt service payments due in the next twelve months and reserve funds set aside to make up potential future deficiencies. A bond trustee holds these funds.

Cash security deposits received by the Port pursuant to lease agreements are held in the City Treasury. Other lessee deposits are renewable certificates of deposit tendered by tenants in lieu of cash and held by banks as third-party certificates in the name of the Port.

Capital outlay funds are restricted for use in construction and acquisition of equipment, due to restrictions from grant agreements and bond resolutions.

Materials and Supplies

Materials and supplies are used for construction and maintenance of Port facilities and are stated at average cost.

Capital Assets

Land transferred to the City in February 1969 is stated at an amount which includes an increase over historical cost of \$56,063,000. This amount was recorded by the State in prior years to reflect appraised values in 1929.

Capital assets purchased are stated at cost and it is the policy of the Port to capitalize all expenditures of more than \$50,000 for infrastructure and facilities and improvements and \$5,000 for equipment and vehicles with an estimated useful life in excess of one year. Property received by donation or by termination of a lease is carried at estimated fair value at the date received. Donated surplus equipment received from the federal government is carried at an estimated fair value determined in accordance with federal guidelines. Interest paid on bond funds used for construction purposes, less interest earned on the temporary investment of the proceeds of such tax-exempt borrowings, if applicable, is capitalized from the date of borrowing through the construction period.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

2. Significant Accounting Policies (Continued)

Depreciation expense is calculated using the straight-line method over the following estimated useful lives of the assets:

Facilities and improvements	5 to 65 years
Machinery and equipment	2 to 20 years
Infrastructure	15 to 40 years

Tenant improvements (building) are amortized using the straight-line method over the shorter of the estimated life of the asset or the remaining term of the related lease. Maintenance and repairs are expensed as incurred.

Dredging costs are amortized using the straight-line method over the estimated useful period ranging from one to seven years.

The Port's Waterfront Land Use Plan was approved by the City Board of Supervisors in September 1997. The costs of the plan are amortized using the straight-line method over an estimated life of 20 years.

Other Assets

Bond issue costs are amortized using the straight-line method over the life of the bond. Original bond issue premiums are offset against the related debt and amortized using the straight-line method which approximates the effective interest method over the life of the bonds.

Deferred Credits

Deferred credits consist primarily of rent credits issued to tenants for certain improvements to Port facilities. Rent credits are recognized on a straight-line basis or in accordance with the terms of the lease agreements.

Pollution Remediation Obligations

Pollution remediation obligations (see Note 16) are measured at their current value using a cost-accumulation approach, based on the pollution remediation outlays expected to be incurred to settle those obligations. Each obligation or obligating event is measured as the sum of probability-weighted amounts in a range of possible estimated amounts. Some estimates of ranges of possible cash flows may be limited to a few discrete scenarios or a single scenario, such as the amount specified in a contract for pollution remediation services.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

2. Significant Accounting Policies (Continued)

Operating Revenues and Expenses

The Port distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from real estate leasing, maritime and other principal ongoing activities of the Port's normal business operations. Real estate revenues consist principally of rentals of Port property to industrial, commercial, retail, office and other business enterprises. Maritime revenues are derived from vessel operations, layberthing, ship repair, harbor services and other maritime activities. Vessel operations include dry, liquid bulk, and break bulk cargoes, cruise, and other berthing. Other operating revenues include building permit and inspections fees. Operating expenses include facility maintenance, the cost of operations, administrative expenses, and depreciation and amortization on capital assets. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Minimum base rental revenue is recognized on the straight-line basis over related lease terms. Most term leases provide rents to be payable to the Port in equal monthly installments on the first day of each month until the lease termination. Contingent rentals are recorded or accrued only for periods in which thresholds for gross sales or revenues are met by the tenant. Use fees are recorded when the fee is based on actual occupancy or use. Use fees are assessed by a measured unit (e.g. lineal feet of vessel for dockage) or measured time (e.g. per twenty-four hour day). Maritime activity or use fees may be based on a standardized tariff schedule or covered by specific contractual agreements.

Capital Contributions

The Port, at various times, receives Federal and State grants and other funds from external sources for construction and/or rehabilitation of waterfront facilities. The funds are reported as capital contributions on the statement of revenues, expenses and changes in net assets.

Effect of New Pronouncement

In 2009, the City and Port implemented GASB Statement No. 49 (GASB 49) *Accounting and Financial Reporting for Pollution Remediation Obligations*, which requires the recording of obligations addressing the current or potential detrimental effects of existing pollution through pollution remediation activities such as site assessments and cleanups. Such obligations, or components of the obligations, are accrued as a liability and expense when a range of expected outlays is reasonably estimable. The scope of GASB 49 excludes pollution prevention or control obligations in current operations, and future pollution remediation activities that are required upon retirement of an asset. The disclosures required by GASB 49 are provided in Note 16.

Restatement of Net Assets

Net assets as of June 30, 2008 have been reduced by \$43.0 million. As allowed by GASB 49, existing pollution remediation liabilities associated with the Pier 70 project area (see Note 16) from prior periods in the amount of \$27.5 million is being recognized as a reduction of beginning net assets. In addition, Port management determined in 2009 that certain land improvements (principally street improvements) that had not been depreciated were exhaustible assets and should have been depreciated in prior periods. Beginning net assets at June 30, 2008 have been restated by \$15.5 million for the required accumulated depreciation and related adjustments of such land improvements (see Note 5).

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

2. Significant Accounting Policies (Continued)

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Cash and Investments

The Port's cash and investments at June 30, 2009 are as follows (in thousands):

Cash and investments in City Treasury	\$ 85,094
Cash outside of City Treasury	5
Restricted assets:	
Cash and investments in City Treasury	9,364
Deposits and investments outside of City Treasury:	
Cash and investments held by bond trustee	6,618
Lessee deposits	<u>440</u>
	<u><u>\$ 101,521</u></u>

City's Treasurer's Pool

The Port maintains its operating fund cash and investments and a portion of its restricted asset cash and investments as part of the City's pool of cash and investments. The notes to the basic financial statements of the City provide more detailed information concerning deposit and investment risks associated with the City's pool of cash and investments at June 30, 2009.

The City's pool is invested pursuant to investment policy guidelines established by the City Treasurer, subject to review by the Treasury Oversight Committee. The Treasury Oversight Committee, established under California Government Code Sections 27130 to 27137, is composed of various City officials and representatives of agencies with large cash balances. The objectives of the policy are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The provisions of the City's investment policy also address interest rate risk, credit risk, custodial credit risk and concentration of credit risk and provides for additional restrictions related to investments.

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Notes to Financial Statements
For the Year Ended June 30, 2009

3. Cash and Investments (Continued)

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally the longer the maturity period of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the City Treasurer manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The City's pool is not registered with the SEC as an investment company and is not rated.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments; however, it is the practice of the City Treasurer that all investments are insured, registered or held by the Treasurer's custodial agent in the City's name. To address concentration of credit risk, the policy specifies authorized investment types and sets parameters for maximum maturity, maximum percentage of the total portfolio which may be invested in specific investment types, and maximum investment to one issuer for certain investment types. U.S. Treasury and Agency securities are not subject to this limitation.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging authorized securities as collateral. The fair value of pledged securities must equal at least 110 percent of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2009, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

3. Cash and Investments (Continued)

The following table shows the maturity of the City's pooled investments by:

Investment maturities (in months)			
Under 1	1-6	6-12	12-36
9.9%	27.0%	8.8%	54.3%

At June 30, 2009, the City's pooled investments have a weighted average maturity of 1.6 years.

Cash and Investments Outside of City's Treasurer's Pool

Lessee security deposits are held on behalf of the Port by third party trustees and invested in renewable certificates of deposit. Deposits that are made by tenants directly to banks are held outside of the City Treasury and are not collateralized as public agency deposits.

Bond Interest and Redemption Held by Trustee

At June 30, 2009 cash and investments held in reserve and for debt service payments by trustee consist of (in thousands):

Reserve Account:	
U.S. Treasury Mutual Fund	\$ 2,058
Debt Service Accounts:	
U.S. Treasury Mutual Fund	4,560
	<u>\$ 6,618</u>

Investment of all funds and accounts held by the bond trustee are governed by the Bond Indenture (Indenture) rather than the general provisions of the California Government Code or the City's investment policy. Investments held by the bond trustee consist of a single U.S. Treasury mutual fund, with weighted average maturity of 57 days. The mutual fund has a Standard & Poor's rating of AAAM. All accounts with the bond trustee were liquidated following the final debt service payments on July 1, 2009 (see Note 7).

4. Receivables

Receivables consisted of the following at June 30, 2009 (in thousands):

Accounts receivable from tenants and customers	\$ 5,346
Less allowance for doubtful accounts	<u>(1,310)</u>
Accounts receivable, net	4,036
Grants receivable	1,184
Other	<u>140</u>
	<u>\$ 5,360</u>

**PORT COMMISSION
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Notes to Financial Statements
For the Year Ended June 30, 2009

5. Capital Assets

A summary of changes in capital assets for fiscal year ended June 30, 2009 are as follows (in thousands):

	Balance July 1, 2008 (as restated)	Increases	Decreases	Balance June 30, 2009
Capital assets, not being depreciated:				
Land	\$ 104,345	\$ 1,237	\$ -	\$ 105,582
Construction in progress	32,730	6,911	33,484	6,157
Total capital assets, not being depreciated	137,075	8,148	33,484	111,739
Capital assets, being depreciated:				
Facilities and improvements	320,632	4,304	-	324,936
Machinery and equipment	16,527	861	887	16,501
Dredging	2,701	3,369	1,928	4,142
Waterfront Land Use Plan	2,779	-	-	2,779
Infrastructure	1,069	26,843	-	27,912
Total capital assets, being depreciated	343,708	35,377	2,815	376,270
Less accumulated depreciation for:				
Facilities and improvements	204,173	8,906	-	213,079
Machinery and equipment	11,027	1,249	887	11,389
Dredging	1,697	1,783	1,928	1,552
Waterfront Land Use Plan	1,254	165	-	1,419
Infrastructure	571	1,245	-	1,816
Total accumulated depreciation	218,722	13,348	2,815	229,255
Total capital assets, being depreciated, net	124,986	22,029	-	147,015
Capital assets, net	\$ 262,061	\$ 30,177	\$ 33,484	\$ 258,754

Port management determined in 2009 that certain land improvements that had not been depreciated were exhaustible assets and should have been depreciated in prior periods. In connection with the restatement adjustment discussed in Note 2, accumulated depreciation as of July 1, 2008 has been increased by \$12,332,000 and improvements of \$3,195,000 have been written off.

Total interest expense was \$544,000 and total interest income was \$2,596,000 for fiscal year 2009. No interest costs were capitalized in 2009.

Facilities and improvements include pier substructures which have an estimated useful life greater than 50 years. Such long-lived assets totaled \$21,915,000 as of June 30, 2009. The cost of fully depreciated assets still in use was approximately \$121,078,000 at June 30, 2009.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

6. Other Assets

Other assets consisted of the following at June 30, 2009 (in thousands):

Noncurrent tenant accounts receivable	\$ 765
Other deferred costs	104
Total other assets	<u>\$ 869</u>

Noncurrent tenant accounts receivable represent the long-term portion of lease or other agreement obligations from tenants that will be collected in future years, including an installment payment agreement with a City department. In connection with a former subtenant and operator of a municipal tow yard on Port property, the Port and the City department agreed to a five-year monthly payment plan for certain rents still due to the Port. The Port Commission approved the installment payment plan in 2005 for total outstanding rents of \$193,000 plus interest at 2% per annum.

7. Bonds, Loans and Other Payables

The changes in bonds, loans and other payables for the year ended June 30, 2009 are as follows (in thousands):

	July 1, 2008 (as restated) see Note 2	Additional Obligations and Net Increases	Retirements and Net Decreases	June 30, 2009	Amounts Due Within One Year
Bonds payable:					
Revenue bonds	\$ 8,505	\$ -	\$ 4,185	\$ 4,320	\$ 4,320
Less deferred amounts:					
For issuance premiums	76	-	76	-	-
On refunding	(262)	262	-	-	-
Total bonds payable	<u>8,319</u>	<u>262</u>	<u>4,261</u>	<u>4,320</u>	<u>4,320</u>
Other payables:					
Loans payables	3,107	-	92	3,015	96
Loan from City department	83	653	-	728	57
Accrued vacation and sick leave pay	1,941	196	135	2,002	1,138
Accrued workers' compensation	2,543	274	510	2,307	365
Other postemployment benefits	2,805	3,011	-	5,816	-
Estimated claims payable	1,121	301	522	900	600
Pollution remediation obligations (see Note 2 and 16)	27,880	244	130	27,994	494
Other liabilities (see Note 16)	2,800	-	-	2,800	-
Long-term obligations	<u>\$ 50,599</u>	<u>\$ 4,941</u>	<u>\$ 5,650</u>	<u>\$ 49,882</u>	<u>\$ 7,070</u>

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

7. Bonds, Loans and Other Payables (Continued)

Annual debt service requirements for all bonds and loans outstanding as of June 30, 2009 are as follows (in thousands):

Fiscal Year Ending June 30	Revenue Bonds		Loans Payable	
	Principal	Interest	Principal	Interest
2010	\$ 4,320	\$ 75	\$ 96	\$ 136
2011	-	-	100	131
2012	-	-	105	127
2013	-	-	110	122
2014	-	-	115	117
2015-2019	-	-	655	504
2020-2024	-	-	817	342
2025-2029	-	-	1,017	141
Total	\$ 4,320	\$ 75	\$ 3,015	\$ 1,620

Fiscal Year Ending June 30	Loan from City Department		Total	
	Principal	Interest	Principal	Interest
2010	\$ 57	\$ 8	\$ 4,473	\$ 219
2011	175	21	275	152
2012	181	14	286	141
2013	187	8	297	130
2014	128	2	243	119
2015-2019	-	-	655	504
2020-2024	-	-	817	342
2025-2029	-	-	1,017	141
Total	\$ 728	\$ 53	\$ 8,063	\$ 1,748

In August 2004, the Port issued \$19,940,000 in Revenue Refunding Bonds (Series 2004) with an average interest rate of 3.16% to refund \$23,175,000 of Series 1994 Revenue Bonds with an average coupon rate of 5.84%. The Port pledged future net revenues to repay the \$19,940,000 in Revenue Bonds issued in 2004. The final annual principal and interest payments on the bonds require less than 45% of net pledged revenues as calculated in accordance with the bond indenture. Principal and interest payments for the year ended June 30, 2009 were \$4,407,000 and net pledged revenues were \$9,895,000 for the year ended June 30, 2009.

The bonds were fully repaid on the final maturity date of July 1, 2009. The final remaining bonds had interest rates of 2.80% to 4.00%.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

7. Bonds, Loans and Other Payables (Continued)

Under the terms of the Indenture, as amended, the Port is required to deposit in a reserve fund with a trustee, an amount equal to the lesser of (a) maximum debt service accruing in any year during the life of such bonds, (b) ten percent (10%) of the proceeds derived from the sale of Series 2004 Bonds, or (c) 1.25 times the average annual debt service due with respect to Series 2004 Bonds. At June 30, 2009, the Port was in compliance with this bond indenture requirement.

While Series 2004 Bonds are outstanding, the Port may not create liens on its property essential to operations, dispose of any property essential to maintaining revenues or operating the Port, and must maintain specified insurance. Covenants of the Indenture include that the Port will maintain its business operations, establish and maintain rentals, rates, fees, and charges for the use of Port property and for services rendered by the Port so that the net revenue, as defined in the bond indenture, in each fiscal year will be at least equal to 130% of aggregate annual debt service for such fiscal year. At June 30, 2009, the Port was in compliance with such bond covenants.

The Series 2004 Revenue Bonds are subject to an arbitrage rebate requirement. Under U.S. Treasury Department regulations, all governmental tax-exempt debt issued after August 31, 1986 are subject to arbitrage rebate requirements. The requirements stipulate, in general, that earnings from the investment of the tax-exempt bond proceeds that exceed related interest costs on the bonds must be remitted to the federal government on every fifth anniversary of each bond issue. The cumulative arbitrage liability as of June 30, 2009 was approximately \$76,000 and was included in other current liabilities.

The Port has entered into a loan agreement with the California Department of Boating and Waterways (Cal Boating) for \$3.5 million to finance certain Hyde Street Harbor improvements. The loan is subordinate to all bonds payable by the Port and interest accrues at a rate of 4.5% per annum on the unpaid balance over 30 years. The project was completed in 2002 and annual payments commenced on August 1, 2002. The loan is secured by gross revenues originating from fees and rentals charged and received within the project area of Hyde Street Harbor. Principal and interest payments for the year ended June 30, 2009 were \$232,000 and pledged gross revenues were \$106,000 for the year ended June 30, 2009.

The San Francisco Public Utilities Commission (SFPUC) advanced funds to construct certain energy efficiency projects at identified Port facilities. The Port is committed to repay such advances over a four year period commencing in fiscal 2009-2010, with interest at 3.5% per annum.

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
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Notes to Financial Statements
For the Year Ended June 30, 2009

8. Operating Revenues – Property Rentals

Certain property rental agreements specify rental payments based on a percentage of tenant sales, subject to a minimum amount. For the year ended June 30, 2009, property rental revenues were comprised as follows (in thousands):

Minimum rentals, all revenue types	\$ 47,031
Percentage rentals	11,111
Total	<u>\$ 58,142</u>

The future minimum rent revenues under noncancellable operating leases having terms in excess of one year as of June 30, 2009 are as follows (in thousands):

Year Ending June 30	
2010	\$ 29,573
2011	26,241
2012	24,299
2013	21,073
2014	18,878
2015-2019	79,981
2020-2024	66,364
2025-2029	52,460
2030-2034	48,917
2035-2039	41,021
2040-2044	26,300
2045-2049	21,648
2050-2054	10,266
2055-2059	8,633
2060-2064	8,561
2065-2069	5,472
2070-2074	1,568
2075	313
Total	<u>\$ 491,568</u>

Property subject to operating leases and property held for lease at June 30, 2009 consisted of the following (in thousands):

Land	\$ 52,546
Facilities and improvements at cost, net of accumulated depreciation	<u>70,330</u>
Total	<u>\$ 122,876</u>

**PORT COMMISSION
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Notes to Financial Statements
For the Year Ended June 30, 2009

9. Retirement Plans

City and County of San Francisco

Plan Description - The City has a single-employer defined benefit retirement plan (the Plan) which is administered by the San Francisco City and County Employees' Retirement System (the Retirement System). The Plan covers substantially all full-time employees of the Port along with other employees of the City. The Plan provides basic service retirement, disability and death benefits based on specified percentages of defined final average salary and provide cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to qualified survivors. The San Francisco City and County Charter and Administrative Code is the authority which establishes and amends the benefit provisions and employer obligations of the Plan. The Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, California 94102 or by calling (415) 487-7020.

Funding Policy - Contributions are made to the basic plan by both the Port and its employees. Employee contributions are mandatory. Employee contribution rates for 2009, 2008 and 2007 varied from 7.0% to 8.0% as a percentage of covered payroll costs. The Port is required to contribute at an actuarially determined rate which was 4.99% for the year ended June 30, 2009, 5.91% for the year ended June 30, 2008, and 6.24% for the year ended June 30, 2007. The Port's employer contributions amounted to \$994,000, \$1,113,000, and \$1,133,000 for 2009, 2008, and 2007, respectively. Since 2005, substantially all required employee contributions were paid to the Retirement System by such affected employees.

For those groups of employees not mandated by collective bargaining agreements to contribute to the Retirement System, the Port's contributions remained at 7.0% to 8.0% of covered payroll costs. The Port's contributions to the Retirement System on behalf of its employees amounted to \$160,000, \$151,000, and \$148,000, for the years ended June 30, 2009, 2008, and 2007, respectively.

The City's basic financial statements contain disclosures and Required Supplementary Information (RSI) for all covered City employees. Amounts for the Port are not separable from the City totals in those disclosures.

10. Health Service System

Health care benefits for Port employees, retired employees and surviving spouses are financed by beneficiaries and by the City principally through the City and County of San Francisco Health Service System. The annual contribution to the City health plan is determined by Charter provision based on similar contributions made by the ten most populous counties in California. The Port's payments for all health care benefits amounted to approximately \$3,748,000, \$3,529,000, and \$3,252,000 in fiscal years 2009, 2008 and 2007, respectively.

The City Health Service System issues a publicly available financial report that includes financial statements and required supplementary information for the health care benefits. That report may be obtained by writing to the San Francisco Health Service System, 1145 Market Street, Suite 200, San Francisco, CA 94103 or by calling (800) 541-2266.

**PORT COMMISSION
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Notes to Financial Statements
For the Year Ended June 30, 2009

11. Other Postemployment Benefits (OPEB)

Plan Description – The City provides health care benefits for Port employees, retired employees and surviving spouses through the City's Health Service System.

Funding Policy - The City has determined a City-wide Annual Required Contribution (ARC), interest on net Other postemployment benefits other than pensions (OPEB) Obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries. The City's allocation of the OPEB related costs to the Port for the year ended June 30, 2009 based upon its percentage of City-wide payroll costs is presented below. Included in the Port's payments for all health care benefits amounts are approximately \$905,000, \$856,000, and \$789,000 for 2009, 2008 and 2007, respectively, to provide postretirement benefits for retired employees in the City Health Service System, on a pay-as-you-go basis. In addition, the City allocated an additional \$28,000 and \$36,000 to the Port's contribution allocation for payment made from the Health Service System for postretirement health benefits in 2009 and 2008, respectively.

The following table shows the components of the City's annual OPEB allocations for Port for the year, for the amount contributed to the plan, and changes in the City's net OPEB obligation (dollar amount in thousands):

	<u>2009</u>	<u>2008</u>
Annual required contribution	\$ 3,913	\$ 3,697
Interest on Net OPEB Obligation	121	-
Adjustment to annual required contribution	<u>(90)</u>	<u>-</u>
Annual OPEB cost (expense)	3,944	3,697
Contribution made	<u>(933)</u>	<u>(892)</u>
Increase in net OPEB obligation	3,011	2,805
Net OPEB obligation - beginning of year	<u>2,805</u>	<u>-</u>
Net OPEB obligation - end of year	<u><u>\$ 5,816</u></u>	<u><u>\$ 2,805</u></u>

Proposition B

Proposition B, passed by the voters on June 3, 2008, increased the years of service required to qualify for employer-funded retiree health benefits for City employees who were hired on or after January 10, 2009. Employees hired before January 10, 2009, became eligible to participate in the retirement health care system after five years of service, and the employer paid 100% of the contribution. Post Proposition B, between five to ten years there is no employer contribution, at ten to fifteen years there is a 50% contribution, between fifteen to twenty years there is a 75% contribution, and only after twenty years of service will the employer pay 100% of the contribution.

Proposition B also required that a separate Retiree Health Care Trust Fund be created to pay for the City's future costs related to retiree health care. This new trust fund, upon establishment, will be funded by employer and employee contributions for employees hired on or after January 10, 2009. New employees contribute up to 2% of their pre-tax pay and employers contribute 1%.

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11. Other Postemployment Benefits (OPEB) (Continued)

Proposition B is expected to reduce the number of people who would eventually have been eligible for paid benefits and create significant savings for the City as investment earnings in the trust will help pay for the cost of the benefits going forward. By 2031 the majority of employees will be under the new benefit plan, and based on the City's actuarial analysis, the proposed funding of 3% of salary is estimated to be sufficient to cover the cost of the benefits on an ongoing basis. Proposition B is also expected to partially reduce the financial impact on the City in meeting its current unfunded OPEB liability.

The City issues a publicly available financial report that includes the complete note disclosures and required supplementary information related to the City's postretirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, California 94102, or by calling (415) 554-7500.

12. Wellness Incentive Program

In 2003, the City established a Wellness Incentive Program (the Program) to promote workforce attendance. Under the Program, any full-time employee leaving employment of the City upon service or disability retirement may receive payment for a portion of accrued sick leave at the time of separation. The amount of this payment is based on two and one-half percent of accrued sick leave at the time of separation times the number of whole years of continuous employment times an employee's salary rate, exclusive of premiums or supplements, at the time of separation. Vested sick leave credits, as set forth under Civil Service Commission Rules, are not included in this computation. Under amended collective bargaining agreements that originally became effective July 1, 2006, the Program continues through June 30, 2010. The estimated future payments under the Program are included in accrued vacation and sick leave pay.

13. Related Party Transactions

The Port receives services from, and provides services to, various City departments that are categorized in the various operating expense line items in the statement of revenues, expenses and changes in net assets. In 2009, the \$12,846,000 in services provided by other City departments included \$1,615,000 of insurance premiums and \$274,000 in workers' compensation expense. Charges of \$1,431,000 for electrical service provided by the San Francisco Public Utility Commission (SFPUC), is included in utilities on the statement of revenues, expenses and changes in net assets. Services provided by City departments include but are not limited to: fireboat operations and maintenance from the Fire Department, legal and litigation-related services from the City Attorney's Office, street cleaning, direct and contractual service from the Department of Public Works, the Purchasing, contract compliance review services by the Human Rights Commission, security services from the Police Department, and real estate services from the Department of Real Estate. Rental revenues from City departments included in operating revenues were approximately \$5,249,000 in 2009.

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13. Related Party Transactions (Continued)

The Port continues to evaluate its payments to the General Fund and various City departments for services that support activities within the Port area and refine the methodologies used for the allocation of City direct and indirect costs.

Under a memorandum of understanding with the San Francisco Public Utilities Commission (SFPUC), SFPUC is advancing funds to provide for the design and construction of certain energy efficiency projects at identified Port facilities (Note 7). Contract work for recommended lighting retrofits was completed in 2009 (\$728,000). The heat, ventilating, and air conditioning (HVAC) and refrigeration portion will proceed in fiscal 2009-2010. It is anticipated that retrofit costs will be recovered through future energy cost savings, as well as provide environmental benefits for the wider community through reduced air pollution and greenhouse gas emissions

14. Operating Lease Commitment

The Port has a noncancellable operating lease (sublease) for its offices at Pier 1 from the master tenant which requires the following minimum annual payments (in thousands):

<u>Year Ending June 30</u>	
2010	\$ 3,157
2011	3,157
2012	3,157
2013	3,157
2014	3,157
2015-2019	15,240
2020-2024	14,988
2025-2029	14,987
2030-2034	14,987
2035-2039	14,987
2040-2044	14,987
2045-2049	14,987
2050	<u>250</u>
Total	<u><u>\$ 121,198</u></u>

The Port has an option to purchase the leasehold premises at a price equal to the present value of the remaining base rent due from the Port to the master tenant, effective through the expiration date of the sublease. Rental payments totaled \$3,089,000 in 2009.

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15. Commitments

Capital Development Plan

The Port is presently engaged in various development projects which involve a commitment to expend significant funds. Under an agreement (The San Francisco Waterfront Special Area Plan) with the San Francisco Bay Conservation and Development Commission, finalized in 2001, the Port is committed to fund and expend up to \$30 million over a 20-year period for pier removal, construction of parks and plazas and other public access improvements. As of June 30, 2009, \$16.7 million of Port funds has been appropriated and \$2.0 million has been expended for projects under the agreement. The \$16.7 million in approved appropriations includes \$9.0 million in proceeds received from the sale of a portion of Seawall Lot 330 to the developer. After expiration of the original development agreement in 2006, the land sales proceeds of \$9.0 million remain designated for the design and construction of a public plaza (Brannan Street Wharf) as required by The San Francisco Waterfront Special Area Plan.

A City general obligation bond, 2008 Clean and Safe Neighborhood Parks, included \$33.5 million for open space projects on Port property. As of June 30, 2009, \$3.6 million has been appropriated and \$0.3 million has been expended from the first issuance of these park bonds. A future issuance will provide additional funding of \$2.9 million for the Brannan Street Wharf project.

Purchase Commitments

The Port had firm purchase and contract commitments at June 30, 2009 for approximately \$7.2 million for capital projects and \$2.6 million for general operations.

16. Contingencies

Litigation

The Port is a defendant in various lawsuits and claims; most deal with personal injury or property damage resulting from accident or fire and are covered by insurance. When the likelihood of an unfavorable outcome is probable, accrued liabilities will include, at minimum, the aggregate amount of deductibles under applicable insurance policies. There are two unrelated pending actions filed by tenants, alleging breach of leases and associated economic losses. Neither tenant has produced credible evidence to support their claimed damages. In one action, the tenant alleges wrongful partial eviction and significant economic losses, but has failed to produce evidence to support such losses. This action is subject to possible further discovery, and the Port's insurer has acknowledged partial insurance coverage (for the eviction claim only), subject to a reservation of rights. Due to insufficient information, no estimate of this loss contingency can be made.

Grants

Certain grants that the Port receives are subject to audit and financial acceptance by the granting agency based upon their review of costs incurred. The Port's management does not believe that such audits will have a material impact on the financial statements.

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16. Contingencies (Continued)

Construction Debris

There is abandoned construction debris at two industrial sites in the Southern Waterfront. Pier 94, Seawall Lot 352, contains approximately 140,000 tons of stockpiled material, consisting primarily of concrete and asphalt debris, left behind by a bankrupt construction material recycling operation. In 2009, the Port entered into a \$605,000 service contract with a new recycling operator to process the stockpile into fill material or other construction products for use or sale. Crushing activities commenced in May 2009 and continued through July 2009. The crushed material remains stored at the site pending Port determination or selection of a use or sale alternative.

A concrete batch plant ceased operations at a site north of Pier 80, abandoning approximately 17,000 cubic yards of concrete debris. Since the abandoned debris hinders leasing and use of the affected premises, the Port has assessed various options for processing and removal of the debris. The estimated cost of the disposal options range from \$200,000 to \$500,000.

As of June 30, 2009, the Port has accrued estimated costs for processing and removal of the debris totaling \$0.7 million recorded as other current liabilities.

Drydock #1

In November 2002, a maritime vessel known as Drydock #1 broke free from its moorings at Pier 70 and went adrift in very high winds, finally running aground on Yerba Buena Island. The recovered drydock is currently moored at a safer harbor location. The Port continues to evaluate options for the final disposition of this surplus vessel. Engineering consultants have assessed requirements for hazardous materials abatement, including potential remediation of lead-based paints, heavy-metal contaminated sediments, and asbestos. The consulting engineers also performed a preliminary structural assessment and condition survey to assess the viability of towing the vessel from its present location to a location for ultimate disposal. Due to its poor condition, the drydock is most likely only salvageable for scrap metal. Based on the information from various consultants and internal engineering estimates, \$2.8 million was accrued in 2008 for the drydock's final disposition, including the remediation of identified hazardous materials and is reported as other noncurrent liabilities. The Port is also pursuing federal financial assistance towards the final disposition cost of Drydock #1.

Environmental

The Port is required to comply with a number of federal, State and local laws, regulations, and permits designed to protect human health, safety and the environment. In conforming to these laws, the implementing regulations and permits, the Port has instituted a number of compliance programs and procedures.

It is the Port's intent that its environmental compliance programs be compliant with regulatory and legal requirements while effectively managing financial resources.

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16. Contingencies (Continued)

The Port's financial statements include liabilities, established and adjusted periodically, based on new information, in accordance with applicable generally accepted accounting principles in the United States of America, for the estimated costs of compliance with environmental laws and regulations and remediation of known contamination.

As future development planning is undertaken, the Port evaluates its overall provisions for environmental liabilities in conjunction with the nature of future activities contemplated for each site and accrues a liability, if necessary. It is, therefore, reasonably possible that in future reporting periods current estimates of environmental liabilities could materially change.

Port lands are subject to environmental risk elements typical of sites with a mix of light industrial activities dominated by transportation, transportation-related and warehousing activities. Due to the historical placement of fill of varying quality, and widespread use of aboveground and underground tanks and pipelines containing and transporting fuel, elevated levels of petroleum hydrocarbons and lead are commonly found on Port properties. Consequently, any significant construction, excavation or other activity that disturbs soil or fill material may encounter hazardous materials and/or generate hazardous waste.

The Port has identified certain environmental issues related to Port property, including asbestos removal, fuel tank removal and oil contamination. The Port may be required to perform certain clean-up work if it intends to develop or lease the property, or at such time as required by the City or State. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for such risk cannot be reasonably made at this time.

Potrero Power Plant – In January 1998, Pacific Gas and Electric Company (PG&E) informed the Port that an environmental investigation at its Potrero Power Plant discovered hydrocarbon on a strip of land owned by the Port. Chemical analyses indicate that these materials contain high levels of polyaromatic hydrocarbons (PAH). PAH contamination also extends beyond the site into offshore San Francisco Bay sediments. PG&E believes that the contaminants are related to historical operations and demolition of a manufactured gas plant that was previously located on the site, and are not from current releases. PG&E is working cooperatively with the Regional Water Quality Control Board to develop remediation plans for the land portion of the site. Because PG&E accepted responsibility for the contamination on land and initiated a voluntary clean-up action, it is unlikely that the Port will be required to bear any of the cost for the landside remediation. However, it is possible that the Port, as a property owner, could be named as a secondarily responsible party if a regulatory order is issued for the clean-up and abatement.

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16. Contingencies (Continued)

PG&E is separately conducting San Francisco Bay sediment investigations under oversight of the Regional Water Quality Control Board. The highest concentrations of PAH center around the outfall for cooling water for the existing power plant. The contaminated sediments appear to be directly related to the historical activities of the power plant site, which PG&E disputes. As the property owner of the seawall and offshore area, the Port could be named as a secondarily responsible party in a regulatory order for clean up and abatement of Bay sediments. The Port has engaged an independent consultant to observe the PG&E sediment investigations and to conduct a separate analytical program, providing the Port an independent data set. The total anticipated contract cost is \$602,000. The contract liability was reduced by approximately \$263,000 which was paid in fiscal 2008-2009. The balance of the contract is included in current pollution remediation obligation (\$121,000) and current estimated claims payable as of June 30, 2009 (\$218,000).

Fuel Pipelines – During a PG&E pipeline removal effort at Pier 90 in 2007, remediation contractors encountered extensive subsurface petroleum contamination within an area previously occupied by a tank farm owned by predecessors to the ExxonMobil Corporation (ExxonMobil). In accordance with state law, Port staff notified the Regional Water Quality Control Board of the petroleum release and performed sampling and site forensics. The Port notified ExxonMobil concurrent with the required regulatory notification. After ExxonMobil's initial failure to respond, the Port threatened to sue ExxonMobil in accord with the provisions of the Resource Recovery and Conservation Act. ExxonMobil subsequently agreed to perform an environmental investigation at the Pier 90 site and Port staff is currently working with ExxonMobil and its consultants to complete that investigation. Potential liability associated with the site is unknown at this time as the full extent of contamination has yet to be determined. No pollution remediation obligation was accrued as of June 30, 2009.

Fuel Terminal at Fisherman's Wharf – ExxonMobil Corporation (or its predecessor company, Mobil Oil Co.) previously operated a fuel terminal on Jefferson Street, adjacent to the Port's Wharf J10. In March 2006, the Regional Water Quality Control Board adopted a "site cleanup requirements" order that names ExxonMobil as a "primary discharger" responsible for petroleum contamination of subsurface soil and groundwater within the area generally bounded by Leavenworth, Jefferson and Hyde Streets, and San Francisco Bay. The order requires ExxonMobil to investigate, remediate, and establish long-term management measures for the subject contamination. In compliance with the Order, ExxonMobil completed site investigation, risk assessment, and a feasibility study of potential remedial alternatives of the site, including a recommended remedial action. ExxonMobil maintains that not all contamination present beneath the area is attributable to its former operations. The Port, as the property owner, is named in the Order as a "secondary discharger".

In May 2007, after demolition of a pile-supported wharf over the shoreline, the Port discovered that small quantities of petroleum are released into the water in the inner lagoon of Fisherman's Wharf at certain times during the tidal cycle. The Port has deployed containment boom around the shoreline where the seepage is most evident to minimize migration of petroleum sheen on the water surface. Based on initial observations, the Regional Water Quality Control Board does not consider this release to pose a significant risk to human health.

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16. Contingencies (Continued)

ExxonMobil maintains that the petroleum seeping from the shoreline and some of the petroleum in groundwater beneath the adjacent land is not related to its former fuel terminal, and has proposed a limited remedial action, followed by re-evaluation of groundwater contamination and visible petroleum seepage. Investigation, consisting of soil, groundwater, and potentially sediment sampling, focused on identifying the source and potential route of petroleum migration from the Wharf J10 area to San Francisco Bay, began in May 2009.

To the extent that this or other contamination beneath Wharf J10 cannot be conclusively attributed to a viable responsible party (i.e. historic contamination may result from entities that no longer exist or from contaminants indigenous to the fill material placed to construct Port facilities), the Port may be liable for some soil and groundwater investigation or remediation. As the existence and/or extent of such contamination are unknown, projections of potential liability cannot reasonably be made at this time. In June 2008, the City and County of San Francisco filed suit against ExxonMobil, demanding that ExxonMobil investigate and remediate petroleum seepage and groundwater contamination as required by the existing Order, and reimburse certain investigation costs incurred by the Port. No pollution remediation obligation was accrued as of June 30, 2009.

Pier 70 – The Port has been conducting a public planning process to produce a preferred master plan for an underutilized 65-acre area commonly known as “Pier 70”. A long history of heavy industrial use has turned this area into a “brownfield” – an underutilized property area where reuse is hindered by actual or suspected contamination. The 65-acre site has been used for over 150 years for iron and steel works, ship building and repair, and other heavy industrial operations. Much of the site was owned and/or occupied by the U.S. Navy or its contractors for at least 60 years. Fifteen acres remain occupied by an on-going ship repair facility. Environmental conditions exist that require investigation and remediation prior to any rehabilitation or development for adaptive reuse. The lack of adequate information about environmental conditions has hindered previous development proposals for Pier 70.

Since early 2007, the Port has been engaged in a community-based master planning process to produce a plan to rehabilitate and reuse many of the historic buildings, enable new development, create parks, open space and other public amenities, complete environmental remediation where required, and preserve existing ship repair facilities. In 2007, the Port completed a site investigation of a small portion of Pier 70: an approximately 17-acre area along the northeast shoreline. This investigation found that soil and sediment are contaminated with metals, petroleum hydrocarbons and PCBs at concentrations that do not pose a hazard to human health or the environment under existing conditions, but will require removal or capping of surface soil before development of the area for public access and recreation.

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16. Contingencies (Continued)

With funding from a federal grant, the Port proceeded in fiscal 2008-2009 with a \$1.2 million contract to investigate soil and groundwater conditions throughout the site, including the fifteen-acre portion leased to the Port's ship repair tenant; survey many of the historic buildings for hazardous building materials, such as lead and asbestos; and abate hazardous materials in select building or buildings to the extent that funding is available. The contractor's sampling work will be conducted between August and November 2009. Environmental conditions that require remediation, for which the Port and/or other responsible parties would be required to address, may be discovered. Depending on the results of the investigation, remediation may range from removal of "hot spots" and subsequent implementation of risk management measures, to design, install and operate an active remediation system, such as groundwater and/or vapor extraction and treatment. In many cases, site remediation or mitigation is most efficiently and effectively conducted in conjunction with site development. As of June 30, 2009, the net local share of the contract (\$123,000), has been accrued as the current net obligation of the Port at this stage. Federal grant reimbursements are recorded as the qualifying grant-funded expenditures are incurred by the Port.

Earlier in 2009, the contractor prepared a report describing potential remediation scenarios for Pier 70 site and probability of certain contamination being encountered in soil, soil vapor or groundwater, and various degrees of remediation that would be required. The model calculation estimated that soil, groundwater, and soil vapor remediation and/or management (excluding hazardous building materials such as asbestos or lead-based paint) would cost between \$15.0 million and \$50.0 million, with a most likely probability-weighted estimated cost of \$27.5 million. Port management believes the environmental consultant's model calculation is a reasonable estimate of an existing brownfield pollution remediation obligation. The \$27.5 million is recorded as a noncurrent pollution remediation obligation as of July 1, 2008 (see Note 2).

The above mentioned risk assessment and feasibility study will be completed in fiscal 2009-10; and it will more thoroughly inform pollution remediation activities and adaptive re-use of the Pier 70 project area. Additionally, hazardous building materials, such as lead-based paint, asbestos, and mercury and/or PCBs in certain electrical equipment, will have to be abated during the course of rehabilitation of any historic building. Hazardous building materials abatement is very roughly estimated to be 20% of the total construction cost of building rehabilitation.

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16. Contingencies (Continued)

Underground Storage Tanks – The Port's property includes five sites where underground storage tanks (USTs) have been removed, and soil and/or groundwater contamination with petroleum has been identified: Pier 92, Pier 80, Pier 70, 375 Illinois St. (Seawall Lot 340) and 145 Terry Francois Blvd. The Port had investigated contamination related to some of these sites and requested that the City and County Department of Public Health Local Oversight Program (LOP), which implements Regional Water Quality Control Board regulations applicable to USTs in San Francisco, close three of the sites. The LOP agreed to the three closures but requested investigation of two other former UST locations. The work plan for investigation of the sites was approved in July 2009. The LOP is likely to issue a paper closure on one of the four remaining sites. The other three will require sampling and analysis. Upon review of the lab results, the LOP will either issue closure to these other sites or require further investigation or remediation. Investigation costs are estimated at \$50,000 - \$100,000 per site. Equal probability has been assigned to each end of the cost range and \$250,000 has been accrued as current pollution remediation obligations of June 30, 2009 for investigation of four remaining sites. The type and extent of remediation required, if any, is unknown at this time.

Other – Environmental conditions on Port property variously include asbestos and lead paint removal and oil contamination. The Port may be required to perform certain clean-up work if it intends to develop or lease such property, or at such time as required by the City or State. There are sites where groundwater contamination may be later identified, where the Port has primary or secondary responsibility. The potential liability for these risks cannot be reasonably made at this time.

A summary of environmental liabilities, included in noncurrent liabilities, at June 30 2009, is as follows:

	<u>Environmental Remediation</u>	<u>Monitoring and Compliance</u>	<u>Total</u>
Environmental liabilities at July 1, 2008 (as restated)	\$ 27,630	\$ 250	\$ 27,880
Current year claims and changes in estimates	-	244	244
Vendor payments	(130)	-	(130)
Environmental liabilities at June 30, 2009	<u>\$ 27,500</u>	<u>\$ 494</u>	<u>\$ 27,994</u>

As disclosed in Note 2, the July 1, 2008 balance was restated to include the pollution remediation obligation of \$27.5 million pertaining to the Pier 70 project area.

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17. Risk Management

Insurance – General and Workers' Compensation

The Port is subject to various risk of loss including general liability, property and casualty, and workers' compensation. The Port carries commercial insurance for all risks of loss with the following exceptions: i) workers' compensation, ii) property damage to most Port owned vehicles, iii) employee health and accident; and iv) losses due to seismic events.

More specifically, the Port carries the following insurance: i) marine general liability coverage of \$50 million, subject to a deductible of \$75,000 per occurrence; ii) hull and machinery liability coverage of \$3.8 million, subject to a deductible of \$100,000 per occurrence; iii) commercial property insurance for losses up to the insured appraised value of Port facilities, subject to maximum of \$1 billion and a deductible of \$50,000 per occurrence; and iv) public officials and employee liability coverage of \$5 million, subject to a deductible of \$50,000 per occurrence. The Port also carries insurance coverage for employees' dishonesty, auto liability, property damage for certain high value Port vehicles, water pollution, and data processing equipment.

In addition to the above, the Port requires its tenants, licensees, and contractors on all contracts to carry commercial general liability insurance in various amounts naming the Port Commission and the City as additional insureds. Tenants whose operations pose a significant environmental risk are also required to post an environmental oversight deposit, and an environmental performance deposit.

Losses from workers' compensation claims of Port employees, the deductible portion of insured losses, and losses from other uninsured risks must be funded by current revenues or reserves. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years. The administration of workers' compensation, including estimates of recorded and incurred but not reported claims, is provided by the City. The workers' compensation liability as of June 30, 2009 has been evaluated by an independent actuary.

With respect to the general liability accrual, the Port has various unsettled lawsuits filed or claims asserted against it as of June 30, 2009. The Port's General Counsel and management have reviewed these claims and lawsuits in order to evaluate the likelihood of an unfavorable outcome to the Port and to arrive at an estimate of the amount or range of potential loss to the Port. Claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. The estimate for claims liability depends on complex factors, such as inflation, changes in legal doctrines, new discovered information and historical damage awards. Claims are reevaluated periodically to consider such factors and recent claims settlement trends (including frequency and amount of pay-outs). The estimate of the claims liability also includes increases or decreases to previously reported unsettled claims. The general liability reserve is included in estimated claims payables.

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17. Risk Management (Continued)

Changes in the reported liability reserves for June 30, 2009 resulted from the following activity (in thousands):

	<u>General Liability</u>	<u>Workers' Compensation</u>
Beginning of year	\$ 1,121	\$ 2,543
Current year claims and changes in estimate	301	274
Settlements	<u>(522)</u>	<u>(510)</u>
End of year	<u>\$ 900</u>	<u>\$ 2,307</u>

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